STATE OF INDIANA

DEPARTMENT OF FINANCIAL INSTITUTIONS

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Report Pursuant to HEA 1717 (§28) on the Feasibility of the Regulation of Mortgage Brokers by the Indiana Department of Financial Institutions November 1, 2007

Scope of Study

DFI's task pursuant to HEA 1717 was to study the feasibility of the agency assuming the regulatory responsibility for "loan brokers, originators, and principal managers" (collectively "mortgage brokers"). The study was to include a comparison of costs and benefits of both a complaint-based, and a routine examination-based, regulatory system. The DFI was also at liberty to study any other issues related to the licensing and regulation of mortgage brokers that the DFI deemed relevant.

Overview

The DFI currently regulates state chartered banks, credit unions and thrifts, as well as various providers of consumer credit and related services. These include licensed lenders under the Uniform Consumer Credit Code ("UCCC"), pawnbrokers, payday lenders, money transmitters, check cashers, budget service companies, and rental purchase companies. Included in the regulation of consumer lenders under the UCCC is the regulation of second mortgage loans. The agency's depository division also examines mortgages as they relate to the safety and soundness (solvency) of the institutions. Additionally, due to the regulation of these various entities, the DFI has a licensing structure in place; albeit not one that has traditionally accommodated thousands of individual licensees/registrant.

The DFI believes it is essential to address expectations of this timely and important effort. The unfortunate reality is that the absolute best regulatory framework, executed to perfection, will not eliminate or even significantly reduce foreclosures in Indiana in the short run. The factors influencing Indiana's negative foreclosure experience are multiple and systemic, and will not be remedied overnight. Among the most significant issues contributing to Indiana's experience are stagnant residential property values and the significant number of Hoosiers who have entered into loan agreements for which they were not well-suited. The prevailing national mortgage lending environment that dominated the marketplace the past few years largely set aside traditional underwriting standards. All forecasts point to a large number of loans whose interest rates will recast beyond the payment abilities of homeowners in the next 18-24 months.

These issues will not be fixed overnight. In fact, some of the states with the most progressive and established mortgage regulatory structures have experienced foreclosure rates among the highest in the nation. What Indiana can do is put in place a regulatory structure that can help keep this situation from arising again. This must include better coordination of regulatory efforts at the state level, as well as coordinated efforts between state and federal regulators.

Number of Mortgage Broker Entities

The initial issue to be determined in analyzing the feasibility of the DFI regulating mortgage brokers is defining the universe of mortgage brokers to be regulated. Under the current statute, a significant number of brokers are exempt from licensing because they are an approved mortgage originator as determined by the federal Department of Housing and Urban Development, the Federal Housing Administration, and other government sponsored enterprises. Information received recently from the Indiana Securities Commissioner indicates that there are 1,271 licensed mortgage brokers, and another 1,091 brokers operating in Indiana without a license due to one of these exemptions. Informal surveys of other states' regulators indicate that most (and a growing number of) states' statutes do not provide for these exemptions. The primary reason other states do not exempt these brokers from licensing is that the federal agencies and government sponsored enterprises do not examine or regulate these approved brokers. For the purposes of this study, the DFI has assumed that any transfer of authority/responsibility for the regulation of mortgage brokers would be accompanied by the elimination of these licensing exemptions. It is important to note that the current number of licensed brokers and registered loan originators might not be reflective of future numbers given the state of the industry, and increased licensing standards and costs included in the 2007 amendments to the loan broker act. The Securities Commissioner reports some fall-off in licensing in the past several months, and anticipates that this trend will continue through the two-year renewal cycle.

Scope and Cost of Regulation/Examination

The next issue to be addressed is the appropriate scope of regulation. The DFI has, based on information received from the Securities Commissioner and consultations with mortgage regulators in other states, preliminarily determined that a successful routine examination-based regulatory structure for mortgage brokers would require a significant increase in agency staffing, an expansive administrative process for the issuance, renewal, and revocation of licenses, a rigorous examiner training regimen, a significantly increased licensee fee schedule, and an undetermined period of lead time. Additionally, depending on the actual numbers of licensees/registrants, and the determined migration plan, a plan to fund DFI's start-up costs would need to be determined.

The implementation of a complaint-based regulatory scheme by the DFI would require a significant, but less extensive, investment of time, money, and resources by the DFI than would a routine-examination schedule. The DFI is concerned that such an effort, in the short run, would increase costs while not significantly changing the regulatory structure currently in place in the Securities Commissioner's office. Certainly the number of complaints received by the regulator of mortgage brokers will vary, and the current environment is by no means typical. The amount of time necessary to investigate a complaint will be very fact-sensitive (pervasiveness of the alleged bad practice, size of the entity, complexity of the issues, etc.) and any attempt to quantify the necessary man-hours would be nothing more than a guess. The former Securities Commissioner informed the DFI staff that his management evaluates the complaints they receive, and determines an examination priority based on available investigator staffing.

The DFI sought input from various states' mortgage regulators with respect to their regulatory schemes and scope. Regulation of mortgage brokers varies from states that make every effort to conduct routine, periodic examinations to states that do not even have sufficient resources to conduct complaint-based examinations. The states that are attempting to complete routine examinations qualify the description of their approach by stating that they "attempt to" examine all mortgage brokers on a routine basis (typically every 18-24 months). Any efforts by the DFI (or other Indiana regulators) could be enhanced by the use of Model Examination Guidelines ("MEGs") developed jointly by the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR"). Additionally, CSBS and AARMR are working to coordinate interstate examination efforts among state regulating mortgage lenders in multiple jurisdictions.

The State of New Hampshire employs a risk-scoping procedure to prioritize its examinations. Their state banking department uses a two-phase examination approach to meet a statutory examination frequency of every 18 months. The first phase requires all licensees to submit certain information (year-end and interim financial statements, roster of management/changes in management, etc.) to the agency. These reports are reviewed by senior level examiners in order to determine which entities will require an on-site examination. The DFI might require additional information (foreclosures, complaints, etc.) as part of this phase-one exam. New Hampshire licenses and regulates 996 mortgage entities, and reports that they typically can use the phase-one approach in lieu of an on-site examination 25% of the time. They report the use of a staff of 12 examiners (4 senior level examiners and 8 junior examiners) to meet the 18-month mandate using this method. Given Indiana's numbers, this would translate into an examination staff of approximately 28 examiners if the above-mentioned licensing exemption were to be eliminated. Extending the examination frequency to 24 months would reduce this number to approximately 21 examiners.

Other states' mortgage regulators have informed the DFI staff that, while there is no typical mortgage broker examination duration, a two man-day average can be used for forecasting. Given the 2,362 licensed and exempt mortgage brokers, and 200 exam-days per examiner on an annual basis, this schedule of two man-days per examination indicates an increased examination staff of approximately 12 to conduct biennial examinations.

The above analysis indicates a range of necessary staffing from 12 to 21 examiners to perform routine, examination-based regulation of the licensed and exempt mortgage brokers in Indiana. Any fee structure developed to fund these positions would also need to include an additional examination assessment that could be charged in the case of a company whose operations require an inordinate amount of regulatory oversight.

Start-up Costs, Resources

Any consideration of the feasibility of the DFI assuming responsibility for the regulation of mortgage brokers would include up-front transitionary costs in addition to ongoing regulatory costs. In evaluating the up-front costs, the DFI assumed no transfer of employees from the staff of the Securities Commissioner. This assumption was based on the Securities Commissioner's relatively small staff, and the continued investigatory demands of the agency's securities regulation. Instead, the analysis includes projected staffing and timeframes necessary to undertake the additional licensing responsibility.

The DFI is assuming that mortgage broker licensing would require an FBI background check, and would propose that existing licensees be subject to the check at their next renewal. In some states, FBI criminal background checks have resulted in a significant number of license revocations. The DFI is only able to speculate on what the experience might be in Indiana, and has built into its analysis funding and/or staffing an assumption that 10% of existing licensees would be denied at renewal for various reasons (negative criminal background check, inability to acquire a bond, etc.). This 10% estimate is significantly lower than the percentage encountered in the past few years as the State of Ohio undertook this type of licensure review.

As noted earlier, the universe of mortgage entities (licensed and exempt) is 2,362. The total roster of individuals (associated with the 1,271 licensed loan brokers) licensed or registered with the Securities Commissioner is 3,408. Adding the number of exempt entities (1,091) means there are at least 4,499 licensed/registered individuals who would presumably be subject to FBI criminal background checks. This collective universe of entities/individuals necessitates significant lead time, funding, training, and systems in order to undertake this regulatory authority just as it relates to licensing.

The upcoming implementation of the Nationwide Mortgage Licensing System would assist the DFI (or the Securities Commissioner) with the processing and management of new and renewal applications. Attached is a schedule of anticipated staffing and associated costs related to the initial licensing/renewal process, and the subsequent renewal process (Attachment 1). The schedule indicates a requirement of 1,672 man-days, or 8+ full-time employees, to conduct the initial licensing/registration renewal process. As this initial renewal process will likely be more labor intensive than the recurring renewal process, the DFI would not propose an expansion of permanent staff commensurate with this effort. The agency would instead staff its licensing function for the more normalized licensing and renewal process, and utilize examiners (including new examiners training to perform the mortgage broker examinations) and other staff to accommodate the man-days necessary for the initial renewal. The DFI projects that the staffing necessary to complete the ongoing licensing/renewal process will be 850 man-days, or 4+ full-time employees. The DFI recognizes that some of this licensing time might offset part of the regulatory review time contemplated by the State of New Hampshire regulatory model, if that were to be adopted.

Further complicating any consideration of the assumption of regulatory authority for mortgage brokers by the DFI is the uncertainty surrounding efforts of Congress and the various federal regulators. A myriad of bills have been introduced, and multiple regulatory initiatives are being considered. It is not possible at this point to determine how these developments in Washington, D.C. will affect any mortgage regulatory efforts in Indiana and the other states. However, as noted in testimony before the Interim Study Committee on Mortgage Lending Practices and Home Loan Foreclosures (see attached), Congress appears ready to fill any regulatory voids left by the various states' regulatory schemes.

Related Regulatory Matters

Among the issues deemed relevant by the DFI was that while mortgage brokers are currently licensed and regulated, largely on a complaint-basis, by the Indiana Securities Commissioner, first mortgage lenders are not, in many cases, licensed or regulated at all. This fact, coupled with the 2007 amendments to the mortgage broker statute, and contemplated 2008 amendments to that statute, raises the issue as to whether the legislature should consider filling the regulatory gap related to the first mortgage lenders.

As such, the DFI believes the licensing and regulation of first mortgage lenders in Indiana warrants thoughtful consideration. This could be accomplished by amending the Uniform Consumer Credit Code ("UCCC") to include first mortgage loans and to provide specific provisions related to mortgage lending. Currently only very limited disclosure provisions within the UCCC apply to first mortgage loans whether purchase money or refinance. Applying a licensing and regulatory framework over first mortgage lenders can also serve as an integral step in promoting prudent lending practices by mortgage brokers.

If all licensed mortgage lenders are required to ensure that the loans they make meet certain statutory requirements as to underwriting, this will encourage mortgage lenders to provide enhanced oversight over the mortgage brokers with whom they do business. It also may deter those who would otherwise ignore prudent underwriting standards, and this type of statutory/regulatory structure could promote accountability and oversight within the industry.

The Non-Traditional Mortgage Guidance and the Statement on Subprime Lending – which were developed through the joint efforts of federal and state banking and mortgage regulators – can serve as a source for prudent and fair mortgage loan underwriting standards. State and national depository institutions in Indiana are already subject to these guidelines. Application of these to all licensed lenders would create a level playing field and give all mortgage lenders an incentive to ensure full compliance from those brokers and appraisers that assist on the mortgage transaction.

DFI would note that if all lenders are required to be licensed and to comply with prudent underwriting standards with substantial penalties for non-compliance, then the need for routine examinations of brokers is decreased. If the lenders enforce higher standards, then the brokers, loan originators, and appraisers will comply in order to participate in the transaction. Under this regulatory scheme, the lenders will be subject to regular examinations, but not the several thousands of brokers/originators.

Other states are joining forces with federal regulators in two unique pilot examination programs. The first of these pilots brings state examiners together with examiners from the Federal Reserve Board, the Office of Thrift Supervision and the Federal Trade Commission to conduct simultaneous examinations of mortgage companies whose separate charters cross federal and state jurisdiction. The second pilot project is a coordinated effort among the Office of the Comptroller of the Currency ("OCC") and the states of New York and Massachusetts. This program will place state examiners in loan origination companies at the same time the OCC is examining the federally-chartered institutions that acquire loans from those originators. Both pilot programs will provide a window into the mortgage lending process, from origination to funding.

These are examples of the coordinated efforts in developing and implementing cooperative supervision and regulation of mortgage lenders that should help reduce the number of foreclosures in the future.

Attached to this report is written testimony provided by Director Judith G. Ripley to the Interim Study Committee on Mortgage Lending Practices and Home Loan Foreclosures on September 13, 2007, and October 11, 2007 (Attachments 2 and 3, respectively). Also attached are the following documents Director Ripley provided with her testimony: a foreclosure brief issued by the National Governors Association (Attachment 4); a chart summarizing mortgage regulation in the various states (Attachment 5); and an informative *Money Magazine* article (Attachment 6). The final attachment is testimony provided to the committee on October 11, 2007, by John Ryan, Executive Vice President of the CSBS (Attachment 7). The DFI welcomes any comments from the Legislative Council, and looks forward to working with the legislature and other state agencies to address Indiana's foreclosure situation.

SECTION 28. [EFFECTIVE UPON PASSAGE] **(a) As used in this SECTION, "department" refers to the department of financial institutions established by IC 28-11-1-1.**

(b) The department shall study the feasibility of assuming responsibility for regulating all:

(1) loan brokers;

(2) originators; and

(3) principal managers;

required to be licensed or registered under IC 23-2-5 on the date of enactment of this act.

(c) In conducting the study required under subsection (b), the department shall determine the following:

(1) The costs and benefits of implementing a complaint based regulatory system, including:

(A) the budget and staffing needs of the department;

(B) the time required to take all necessary actions to implement the system; and

(C) a comparison of the costs and benefits of implementing the system described in this subdivision with the costs and benefits of implementing a system described in subdivision (2).

(2) The costs and benefits of implementing an examination based regulatory system, including:

(A) the budget and staffing needs of the department;

(B) the time required to take all necessary actions to implement the system; and

(C) a comparison of the costs and benefits of implementing the system described in this subdivision with the costs and benefits of implementing a system described in subdivision (1).

(d) In addition to conducting the required analyses under subsection (b), the department may study any other issues related to the licensing and regulation of loan brokers, originators, and principal managers that the department considers relevant to the department's ability to undertake the responsibilities described in this SECTION.

(e) The department shall provide:

(1) status reports on the department's progress in conducting the study required by this SECTION; and

(2) any preliminary data gathered or determinations made in conducting the study required by this SECTION;

as may be requested by the interim study committee on mortgage lending practices and home loan foreclosures established under this act.

(f) The department shall report its findings and any recommendations to the legislative council not later than November 1, 2007. The department's report to the legislative council under this subsection must be in an electronic format under IC 5-14-6.

(g) This SECTION expires January 1, 2008.

Attachment 1

Processing Applications-Transition

October 29, 2007

Applications: 2,362 Brokers[1]						
	Approved upon initial review: 70%: 1,654	Returned:		Denied for cause: 10% = 236 (Range of tasks: full administrative hearing to informal proceedings leading to applicant withdrawing or abandoning application)		
		Incomplete Applications 15% = 354	Apparent Disqualification 5% = 118			
Hours to perform tasks	Process application – Est. # of hours = 2 **hours = 3,308**	Return application w/ explanation Process application = Est. # of hours = **4 hours = 1,416**	Return application w/ explanation Informal conferences to resolve; Process application = Est. # of hours = **10 hours = 1,180**	Hearing: 5% = 118 Either DFI or Applicant prevail = # of hours = Est. **37.5 hours = 4,425**	Abandoned: 5% = 118 Application withdrawn/abandoned short of formal hearing = Est. # of hours = **18.75 hours = 2,213**	Total Man Hours = **12,542/7.5 = 1,672 man days**
# of Personnel to perform tasks	441 man days	189 man days	157man days	590 man days	295 man days	**1,672 man days / 200 annual work days = 8.36 personnel**

[1] Based upon figures supplied by Securities Commissioner as of 10-07 and includes 4,499 originators. Assumes that broker applications will be annual similar to DFI lender applications. Also, assumes elimination of Government Sponsored Enterprises (i.e. HUD, Fannie Mae, Freddie Mac, etc.) Exemptions.

Processing Applications- Annual

October 29, 2007

Applications: 2,362 Brokers[1]						
	Approved upon initial review: 80%: 1,890	Returned: Incomplete Applications 10% = 236	Returned: Apparent Disqualification 5% = 118	Denied for cause: 5% = 118 (Range of tasks: full administrative hearing to informal proceedings leading to applicant withdrawing or abandoning application)		
Hours to perform tasks	Process application – Est. # of hours = **1.5 hours = 2,835**	Return application w/ explanation Process application = Est. # of hours = **3 hours** = **708**	Return application w/ explanation Informal conferences to resolve; Process application = Est. # of hours = **10 hours** = **1,180**	Hearing: 2% = 47[2] Either DFI or Applicant prevail = # of hours = Est. **20 hours** = **940**	Abandoned: 3% = 71 Application withdrawn/abandoned short of formal hearing = Est. # of hours = **10 hours** = **710**	Total Man Hours = 6,373/7.5 = 850 **man days**
# of Personnel to perform tasks	378 man days	95 man days	157 man days	125 man days	95 man days	**850 man days / 200 annual work days = 4.25 personnel**

[1] Based upon figures supplied by Securities Commissioner as of 10-07 and includes 4,499 originators. Assumes that broker applications will be annual similar to DFI lender applications. Also, assumes elimination of Government Sponsored Enterprises (i.e. HUD, Fannie Mae, Freddie Mac, etc.) Exemptions.

[2] The number of applications requiring a full administrative hearing is expected to decline after the first few years.

Attachment 2

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Testimony of Judith G. Ripley, Director
before the Interim Study Committee
on Mortgage Lending Practices and Home Loan Foreclosures
September 13, 2007 10:00 A.M.

Good morning, Madame Chairperson and members of the committee. Thank you for inviting the DFI participation in this very important mortgage fraud and foreclosure study committee. I am Judy Ripley and I am the director of the Indiana Department of Financial Institutions. With me here today are John Schroeder, General Counsel and Deputy Director for Consumer Credit, and Mark Tarpey, Supervisor for Consumer Credit.

The DFI is a regulatory agency that supervises and examines financial institutions that are chartered or licensed by the state of Indiana. The DFI is a dedicated fund agency that derives all of its funding from the fees paid by the entities that we supervise. We receive no general fund money nor do we contribute to the general fund. The department is governed by a bi-partisan seven-member board appointed by the Governor. Members are appointed for staggered four-year terms and are comprised of persons from the Indiana financial community.

Members are instrumental in determining and approving the fees we charge. We have a staff of 75, 47 of whom are highly trained examiners. The DFI examiners are continuously furthering their examination skills and knowledge by attending training in all areas over which we have supervisory responsibilities. Examiners receive certifications in these various areas and specialties. For example, recently two of our consumer credit examiners completed a five week online interactive course in mortgage fraud. In November, two examiners will attend mortgage examiners school.

It is DFI's job to examine and supervise the various financial institutions that come under titles 28 and 24 of the Indiana Code. This includes banks, savings banks, thrifts, trust companies, credit unions, non-bank lenders, payday lenders, pawnbrokers, rent-to-owns, money transmitters, budget service companies and check cashers. DFI issues the charters, licenses or registrations for these entities and follows up with regular examinations or visits as deemed necessary. DFI regularly examines the state-chartered depository institutions for safety and soundness and compliance with consumer statutes. Additionally, when DFI examines depository institutions we examine their loan portfolios. Specific to the mortgage industry, we currently license and examine 285 non-depository second mortgage lenders for compliance with IC 24-4.5, the Indiana uniform consumer credit code (UCCC). Non-depository first mortgage lenders, whether the transaction is a purchase money loan or a refinance, are not licensed in Indiana. In Indiana, first mortgage lenders only have to maintain minimal compliance with certain provisions of the UCCC (IC 24-4.5-3-105) and the Home Loan Practices Act (IC 24-9) for high cost home loans.

A typical compliance examination of second mortgage lenders would occur approximately every 24 months. The examiner reviews all of the loan documents for compliance with the UCCC and related federal laws. The examiner also looks for any lending practices that are not consistent with the DFI guidelines for nontraditional mortgages and loans to sub prime borrowers. Most of the non-depository second mortgage lenders who are licensed with DFI also offer first mortgage products. At the present time, first mortgage non-depository lenders who are not licensed with DFI to make second mortgage loans have no state licensing or examination in Indiana. This is true of only a handful of other states. The DFI is a member of CSBS, the Conference of State Bank Supervisors. The DFI is also a member of AARMR, the American Association of Residential Mortgage Regulators. About three years ago, CSBS and AARMR began a project to develop a nationwide mortgage licensing system that would be a one-stop registry and licensing system for all mortgage lenders and brokers. CSBS contracted with the National Association of Securities Dealers (NASD) to design this system using the same principles that have been used for the past 20 years for licensing securities brokers. The system is in its final stages of testing and will be operational in January 2008. A few states are scheduled to go on line with the NMLS in 2008. Indiana is scheduled to go on line January 2009. Legislation passed by the General Assembly last session will allow Indiana to participate in the NMLS. To date 39 states have signed on to use this system. We understand that the Securities Division of the Secretary of State's office is also planning to participate in the NMLS for loan brokers.

All mortgage lenders and brokers will apply for licenses through this system. They will pay a transaction fee based on the number of states in which they wish to operate. Their information will then be entered into a database that will be available to participating states. The advantage will be a database that will allow a view of all licensed lenders and brokers across the country. You've already heard about the fraud and abuses rampant in the system now. A nationwide system will help regulators screen an applicant based on his or her actions in other states. This will simplify the licensing process for the licensees as well. Use of the system will be mandatory whether the lender or broker operates in one state or multiple states.

CSBS is also in the process of finalizing a 2-page revised mortgage disclosure for potential mortgage applicants. This would be given to the customer early in the application process, not after all of the paperwork is complete and the closing is scheduled. We have brought a copy of that disclosure for you to review. We believe it would be helpful for this document to be required rather than offered on a voluntary basis.

John Ryan, the executive vice president of CSBS, will be here on October 11th to testify before this Committee regarding the national landscape as to mortgage regulation and to give you an update as to what is expected in the way of federal regulation and legislation as well as updates on the issues of foreclosure and predatory lending.

It is important to note that the mortgage lending picture has changed significantly in the last few years. When the legislature looked at mortgage problems in 2002 and 2003, the emphasis was on mortgage fraud. Since that time, there has been a proliferation of products offered that changed the very nature of mortgage lending. There appears to be no limit to the innovative ways to loan money to subprime borrowers that have surfaced in the last few years. As fast as lenders were able to close those loans, Wall Street was ready to swoop in, bundle them in pools and offer them for sale as securitized debt instruments. As a result of this change, in November of 2006, the DFI and 38 other states adopted the Non-Traditional Mortgage Guidance that was originally drafted by the federal banking agencies. Additionally, in July of this year, the DFI adopted the Subprime Mortgage Statement that was also drafted by federal banking regulatory agencies. You were given a copy of the press release announcing the adoption of those guidelines at the last meeting. The DFI has notified the second mortgage licensees we examine that when we conduct our examinations we will be looking at their compliance with these guidelines not only for second mortgage loans but also first mortgage loans.

HEA 1717 requires the DFI to provide a report to the Legislative Council of the General Assembly in November regarding the feasibility of the DFI assuming the responsibilities for regulating mortgage brokers. This analysis is to be both on an examination basis and on a complaint basis. In the process of preparing this report, we have met with the Securities Commissioner and are contacting other states to determine what their mortgage lender and broker laws are, which agency or agencies regulate the mortgage transaction and what the most successful procedures have been in terms of deterring mortgage fraud and/or predatory lending. We anticipate we will have information compiled by October 11th that will give an overview of other state activities.

As a final remark, this foreclosure crisis is ongoing and I believe the high rate of foreclosures will continue into the foreseeable future. In addition to fraud and subprime lending, other factors including the lack of price appreciation for real estate and imprudent underwriting standards have contributed to this situation. We appreciate this opportunity to discuss this matter with you today and look forward to working with you in the upcoming months.

Attachment 3

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Testimony of Judith G. Ripley, Director
Before the interim study committee
On mortgage lending practices and home loan foreclosures
October 11, 2007 10:00 a.m.

We have prepared a list of possible statutory changes that we believe would go a long way towards the goal of making certain this mortgage foreclosure crisis doesn't happen again. The market is on its way to limiting the current damage to a variety of lenders, investors and – regrettably – a substantial number of borrowers. Some borrowers cannot be helped due to the type of loans they have and their dire financial conditions. Unfortunately, we do not believe you can undo the situation as it currently exists. In fact, this subprime and non-traditional mortgage crisis will continue for some time as an estimated 32% of subprime adjustable rate mortgages are scheduled to reset through 2008. What the DFI is encouraging is consideration of a legislative approach to stop certain abusive practices now so that, hopefully, the problems with subprime and non-traditional mortgages will not happen again. Given the extensive and continuing media coverage of these issues, and the effects on your constituents, I know I do not have to convince you of the importance of this issue.

First, I will list for you several possible legislative remedies for your consideration. I will then expand upon them to provide a more global perspective.

1) Consideration of the licensing and regulation of first mortgage lenders under the uniform consumer credit code (also known as the "UCCC").
2) Consideration should be given to eliminating the numerous exemptions under the loan broker statute for HUD, FHA, VA and other federally related programs.
3) Consideration of increasing the current bonding levels of $50,000 for all mortgage brokers – possibly based on their volume of mortgage loan activity.
4) Consider requiring all appraisers and brokers to undergo FBI criminal background checks.
5) Consider including language to ensure that all licensed and certified appraisers meet the highest standards for the industry in regards to entry into the profession and continuing education requirements.

6) Consider including in the UCCC mortgage loan underwriting standards that are consistent with the Non-Traditional Mortgage Guidance and the Subprime Lending Statement issued by the DFI.
7) Consider including in the UCCC provisions to hold lenders accountable for the activities of the brokers and appraisers used in their loan transactions.
8) Consider including language to provide for civil monetary penalties and other civil and/or criminal actions that would be available to regulators, borrowers, and the courts to punish "bad actors" in the mortgage industry.
9) Consider a requirement that the mortgage documents include one document that contains the sales price, homestead credit information, buyer's signature, and the names and license numbers of all parties involved in the mortgage transaction.
10) Consider the addition of a mandatory financial literacy program to our K-12 school curricula.
11) Consider the requirement of a simplified one or two page disclosure document that would provide prospective borrowers essential, timely information in summary form at least five days prior to closing.

First, as I testified at the last meeting, first mortgage lenders are not licensed in Indiana. As you know, 20 years ago most mortgage loans were obtained from a depository institution or from a mortgage banker who was a "portfolio lender." Since the bank or mortgage company retained the mortgages, they performed thorough due diligence reviews in the underwriting of their loans. In the last several years, the majority of first mortgage lending has moved from banks, credit unions, savings banks or other depository institutions --all of which are regulated and examined-- to the non-depository brokers and lenders whose lending activities are largely unregulated. The incentive to do true underwriting was removed by the financial motivation to complete and sell the loan as quickly as possible.

Buying a home is a financial undertaking that is not surpassed by many other purchases I can name. And for most of us, it is the largest single investment we make in our lives. It is common sense to make certain that all mortgage brokers and lenders are required to maintain the same high standards that we expect from our depository institutions. John Ryan just told you that if the states do not answer the call to act on stricter mortgage regulation and underwriting standards, the federal government is going to mandate it. We believe that our state legislators are better equipped to address problems unique to our state. We also believe that consumers will receive faster, more effective responses to complaints. And you, as policy makers, will be able to set specific standards for compliance and determine appropriate penalties for violations.

Second, the loan broker act exempts from licensing persons who are approved to sell or service loans insured by HUD and various other government sponsored entities, such as Fannie Mae, Freddie Mac and the VA. Consideration should be given to whether or not this exemption is appropriate in today's mortgage lending environment. These exempted brokers are seldom subject to any examination or substantive review by these federal programs. The number claiming the exemption is large: the Securities Commissioner estimated that there are 1,400 brokers claiming exempt status compared with 1,100 brokers who obtain licenses. The DFI has contacted the mortgage broker regulators in numerous states, and the vast majority of these states do not allow these types of exemptions due to the lack of regulatory oversight provided by these federal entities.

By the same token, if first mortgage lenders are to be licensed in this state, consideration should be given to ensuring that no exemptions are available to lenders under these federal programs. From our point of view as a regulator, it is important to place both brokers and lenders in the same regulatory posture so that one group does not have a regulatory advantage over the other. A level playing field for all brokers and lenders is important. The use of the upcoming Nationwide Mortgage Licensing System being developed by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators will provide a nationwide licensing system for all brokers and lenders.

Third, we believe consideration should be given to an increase in the bond required for brokers (and if first mortgage lenders are licensed, for them as well). Consideration should include an analysis of whether the current amount of $50,000 is adequate to compensate borrowers who have been damaged by the activities of a broker or lender. If the circumstances support drawing on a bond, it is likely that numerous borrowers have been hurt by the broker or lender. A more significant bond will demonstrate the commitment of the broker or lender to operate a fair and honest business. Additionally, it is our understanding that once the amount of the bond reaches $100,000, the company issuing the bond would do more rigorous underwriting which would provide heightened confidence in the broker or lender.

Next on our list is a consideration of a requirement that all appraisers and mortgage brokers undergo FBI criminal background checks. You heard testimony at the last committee meeting that the single most common denominator in mortgage fraud schemes is the appraiser. Mortgage brokers currently get a state criminal background check. It is our understanding that the Securities Commissioner intends to amend the loan broker statute in the 2008 session to provide for FBI criminal background checks. The DFI recently met with the FBI regarding procedures for background checks. During that meeting, we learned that in Indiana, taxi drivers and massage therapists are required to undergo FBI background checks. Certainly, consideration of this same standard for appraisers and mortgage brokers is appropriate.

Item number five on appraisals recognizes the fact that an appraisal is the single most important part of the real estate purchase from the perspective of the lender and the customer. Standards for initial licensing and continuing education for licensed or certified appraisers should be among the highest in the industry.

The next item relates to the Guidance for Non-Traditional Mortgages and Subprime Lending Statement that the DFI approved for the second mortgage lenders we examine. We provided you copies of those documents at the last hearing. It is our suggestion that consideration be given to including in the UCCC specific references to the underwriting standards and other provisions of these documents. In that case, compliance with these standards would be a part of any examination conducted by examiners. Basically, these are rules lenders would follow if they were retaining the loan and not selling it into the secondary market. They are common sense rules to assure the borrowers will be able to repay the loan based on prudent underwriting standards and verifiable information.

In conjunction with the Guidance for Non-Traditional Mortgages and Subprime Lending Statement, the DFI also suggests consideration of language that would require mortgage lenders to more effectively monitor the activities of the appraisers and brokers they use on any of their mortgage transactions. Regulators cannot discern all of the inappropriate or illegal activities which occur in the lending industry. If lenders are held accountable for the activities of the brokers and appraisers who participate on their loans, they will work with professionals whom they can trust to employ prudent and responsible lending practices.

Next, we have found that the possibility of significant civil monetary penalties and other statutory penalties serves as a strong deterrent against violating the law. It is, however, sometimes necessary to levy those penalties. Therefore, the DFI encourages consideration of penalties that are high enough to cause a violator to pay for the violation and not simply consider it a cost of doing business. These are remedies which should be available to the customer, the regulators and the courts.

As we testified at the last meeting and as you heard from Donna Eide and Gary Avery, consideration should be given to a requirement that mortgage documents include the names and license numbers of all participants to the loan. This would include both purchase money loans and refinances. Additional consideration should be given to including the sales price of the property, homestead credit information, and the buyer's signature. A single source document would make it much easier to track the history of the transaction and, once again, serve as a disincentive to violate the law. This could be on the warranty deed, the mortgage, or perhaps a stand alone document that could be easily scanned and the information populated in a database allowing regulators, lenders, and borrowers to track "bad actors."

Further, the DFI believes that consideration should be given to the inclusion of a consistent and continuous financial literacy course of study in the K-12 curriculum. Only seven states include a personal finance course as a high school graduation requirement. Students leave high school with little or no understanding of basic financial transactions. College students are laden with high cost credit card debt. It is little wonder that so many people have been entrapped in the subprime and non-traditional mortgage crisis.

Finally, the DFI suggests consideration of the requirement for a simplified, one or two page disclosure similar to the one developed by CSBS. This simplified disclosure clearly states the up-front costs associated with the loan, both the initial and fully-indexed rates and payments, and other information essential to an informed decision. As you are aware, the extensive disclosure requirements currently in place result in a stack of documents that is unreadable, and results in no real disclosure. This simplified form could provide real, meaningful, and timely disclosure.

Again, we appreciate the opportunity to discuss this matter with you today and look forward to our continued efforts in the upcoming months.

NGA Center for BEST PRACTICES

Issue Brief

Attachment 4

September 19, 2007

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STATE STRATEGIES TO ADDRESS FORECLOSURES

Executive Summary

Many factors have shaped the recent spike in subprime mortgage foreclosures, including climbing interest rates, falling housing prices, financially overextended buyers, nontraditional mortgage products, speculation, and predatory lending practices that jeopardize the ability of homeowners to pay their mortgages. This *Issue Brief* examines current and proposed state actions that address challenges in the subprime lending market, help families avoid foreclosure, and prevent predatory lending practices.

During the first quarter of 2007, the percentage of home mortgages entering foreclosure reached its highest point in 28 years. An estimated 2.4 million borrowers with subprime home loans originated between 1998 and 2006 have already lost or will lose their homes to foreclosure.

Foreclosures often cluster in certain neighborhoods, particularly those that are predominantly low-income or minority. Multiple foreclosures in a community can lead to lowered property values, crime, and the deterioration of property, which can cut into a state's tax revenues.

States have a long history governing mortgage lending and foreclosure practices through statute and regulation. States are well-suited to reach out to troubled borrowers to help connect them with the resources necessary to either avoid or mitigate the impact of foreclosure. In response to the recent wave of foreclosures, state policymakers are tailoring initiatives to meet the needs of their citizens and the challenges they face, including:

- Protecting consumers from foreclosure "rescue" scams;
- Connecting borrowers to counseling and resources;
- Facilitating workouts and refinances by working with loan servicers and establishing foreclosure prevention funds; and
- Slowing the foreclosure process.

At the same time, states are acting to prevent future foreclosures by:

- Banning common predatory practices;
- Adopting regulatory guidelines for subprime and nontraditional mortgage products;
- Tightening regulation of mortgage brokers and loan originators;
- Increasing criminal penalties for mortgage fraud, enforcing existing lending laws, increasing funding for supervision, and pursuing violators; and
- Educating homebuyers.

States are using the above strategies to prevent unnecessary foreclosures while working to preserve homeownership and the availability of financial options for low-income residents.

Introduction

From January through June 2007, more than 530,000 families in the United States saw their "American Dream" slip away.[1] During the first quarter of 2007, the percentage of home mortgages entering foreclosure reached its highest point in 28 years, affecting roughly one in every 172 home loans. This rate continued to rise during the second quarter of 2007.[2] By the end of the first quarter, the housing market had waned. Home sales dropped 30 percent below 2005 rates, and median housing prices declined by 3 percent, leaving many homeowners unable to sell their properties.

The rise in foreclosure is partly due to growth in subprime mortgage lending—or lending to consumers with less than stellar credit. In consideration for extending credit to higher-risk borrowers, lenders impose higher interest rates and more costs or fees on subprime loans than on prime loans. In 2006, subprime mortgage originations comprised 20.1 percent of the $3 trillion mortgage market, and in the first quarter of 2007, they accounted for 54 percent of all foreclosures.[3]

Low- to moderate-income families and those with blemished credit histories can benefit from subprime mortgage products because these mortgages provide them access to credit and help them achieve homeownership. However, climbing interest rates, falling housing prices, financially overextended buyers, nontraditional mortgage products, speculation, and the susceptibility of subprime borrowers to "predatory lending"—the practice of originating loans with unfair terms, often through deceptive means—have compounded to place many subprime borrowers in financially tenuous situations.

First American CoreLogic estimates there will be 1.1 million subprime foreclosures by 2014 due to borrowers unable to make increased monthly payments on subprime adjustable rate mortgages. The Center for Responsible Lending (CRL) expects this trend to be even worse, predicting that 2.4 million families with subprime home loans originated between 1998 and 2006 have already lost or will lose their homes to foreclosure, costing families as much as $164 billion. CRL further predicts that 19 percent of subprime mortgages originated since 2004 could end in foreclosure. At the end of June 2007, more than 20 percent of subprime loans were past due.

States have historically provided consumer protections to help families obtain fair and affordable mortgages by enacting laws that protect against usury, mortgage fraud, and predatory lending. To curb the current national foreclosure crisis, state policymakers are reviewing and improving their existing laws to ensure they address the large number of subprime foreclosures while keeping financial options available to low-income borrowers. Since the beginning of 2007, states have launched foreclosure prevention funds, resource hotlines, and free counseling. To enhance regulation and accountability of the mortgage industry, more than 30 states have passed legislation to ban predatory lending practices, strengthen lender oversight, regulate mortgage broker companies and loan originators, and educate potential homebuyers.

This *Issue Brief* focuses on foreclosures in the subprime mortgage market, including those that may have resulted from predatory lending practices. It is divided into three sections:

- **How Did We Get Here?** – The first section provides background on the mortgage lending market and its evolution from restricting credit to overextending credit. It includes definitions of different mortgage loan products; explains the roles of banks, lenders, and brokers; and details predatory lending practices.

- **The Impact of Foreclosure on States, Neighborhoods, and Families** – The second section describes the effect of foreclosure on communities, including financial instability, crime, and local economic decline.
- **State Actions to Help Homeowners** – The final section highlights current state efforts to help troubled borrowers, prevent foreclosure, and curb predatory lending and describes actions governors are taking to keep families in their homes.

How Did We Get Here?

Before the advent of 30-year and 15-year mortgage products, potential homeowners who needed help financing the purchase of a home relied on short-term mortgage loans that required payment in full after a three- to five-year period. The post-Depression era began a transformation to higher levels of homeownership through the formation of the Federal Housing Administration (FHA) and the establishment of long-term, fixed-rate mortgage loans that are common today.

Since then, major legislative actions have helped to open up the mortgage market and extend credit to low-income families. In the 1960s, '70s, and '80s, federal fair housing laws addressed many challenges of access and affordability, such as redlining, or the practice of refusing loans to certain borrowers—often because of their race and income.

In 1977, Congress passed the Community Reinvestment Act, which required banks and lenders to help meet the credit needs of the communities in which they operated.[4] This act was intended to discourage redlining and help families achieve homeownership.

The passage of the Secondary Market Mortgage Enhancement Act of 1984[5] and the subsequent Tax Reform Act of 1986[6] led to the expansion of "mortgage-backed securities" (MBSs) into the private sector, beyond what was offered from government sponsored enterprises (GSEs) such as Freddie Mac and Fannie Mae (see box and chart on page 4).[7]

While these changes increased regulation and oversight of the prime market, the emergence of automated loan origination, selling, and servicing and the unprecedented availability of capital led to the growth of the subprime mortgage loan market under far less regulatory scrutiny. The subprime market extends credit to borrowers with less than stellar credit histories or unreliable income. The number of subprime loans originated in the United States has exploded since the early 1990s, with the share of subprime loans growing from $20 billion in 1993[8] to $332 billion in 2003.[9]

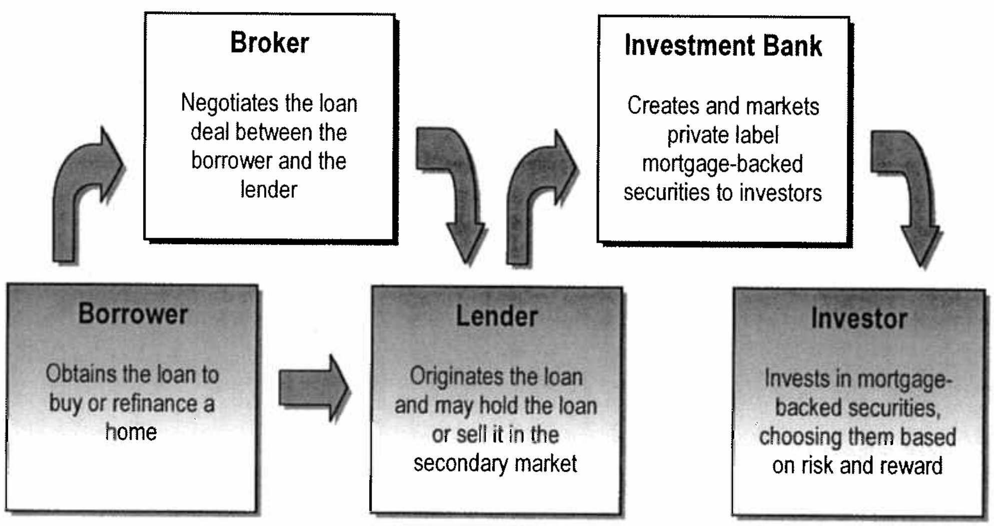
Responsible and fair subprime lending can help low- to moderate-income families achieve homeownership, which may be the single most effective tool for helping them build wealth and gain financial stability. Moreover, homeownership helps to both create and stabilize communities. Homeowners are more likely than renters are to invest in their properties and neighborhoods and participate in community and civic activities.[10] Thus, the financial and social benefits of homeownership make it a cornerstone of personal, civic, and economic growth.

The Role of the Secondary Market

Subprime lending has flourished in recent years because of interest in MBSs from major Wall Street investment banks and a process called securitization. Through securitization, lenders can sell their loans in bulk to the secondary mortgage market (the market where loans are bought and sold) at a profit. The secondary market consists of both GSEs like Freddie Mac and Fannie Mae—regulated by the Office of Federal Housing Enterprise Oversight (OFHEO)—and private investment firms. Investment firms bundle subprime loans (which are considered risky because of the borrowers' higher probability of default) with less risky loans for sale as bonds, or highly rated MBSs. Investment banks sell MBSs to individual investors, who may choose MBSs based on their preferences for risk versus return. (See the chart, "The Cycle of a Subprime Mortgage Loan.")

The housing boom helped drive demand for MBSs. Increased demand made loans to low-income consumers profitable and gave lenders the opportunity to reinvest earnings from MBS sales into other profitable loans. This demand opened the door for weak underwriting and fraudulent practices. Although securitization helps lenders to extend credit to a wider range of borrowers—including those with weak credit histories—by dispersing risk, securitization also makes it difficult for borrowers to restructure and refinance their loans. Many MBSs stipulate that only a certain percentage of loans within the bond may be restructured. If additional borrowers request restructures, a majority of investors must approve. According to Standard & Poor's, about three-quarters of subprime mortgages originated in 2006 were funded by securitizations.

The Cycle of a Subprime Mortgage Loan



Mortgage Lending Primer

The mortgage market has an abundance of new products designed to serve a range of borrowers. The following sections provide a basic overview of loan products, borrowers, and lenders.

Loan Products

The past five years has seen the expansion of nontraditional, or "exotic," loan products. Such products, which have traditionally been available to financially flexible borrowers to build equity or engage in entrepreneurial endeavors, have in recent years proliferated, driven by demand from the secondary mortgage market and investors seeking to profit from rapidly rising home values. However, such loan products can be a gamble for potential homeowners because a sudden market downturn can turn these products from profitable investments to financial liabilities.

Regardless of the loan product structure, borrowers are responsible for all components of the total loan balance. Traditional loan products, such as 15- or 30-year fixed-rate mortgages, set a minimum monthly payment based on principal and interest designed to fulfill the total loan balance by the end of the specified period. Alternatively, exotic loans do not have a fixed monthly payment or fixed interest rate. They allow borrowers to make smaller premium or interest-only payments early in the life of the loan and larger payments later. Borrowers also are responsible for property taxes and insurance premiums, costs that are typically folded into the monthly mortgage payment.

Exotic loan products include:

- **Interest-only loans** that let borrowers pay only the accrued interest on their loans for a fixed grace period, allowing them to make low monthly payments during that time. This type of loan comes with significantly higher payments after the grace period expires because borrowers must begin repaying the principal.
- **Deferred interest loans or negative amortization loans**, which allow borrowers to pay *less* than what they owe in interest and principal during a grace period. These loans have payment and interest rate adjustment caps, meaning that payments stay the same during the grace period even if the interest rate rises. This can increase rather than decrease the size of the loan. As with interest-only loans, borrowers can make low payments to a negatively amortized loan for a fixed period before the monthly payment rises.
- **Hybrid adjustable rate mortgage loans (ARMs)**, which let borrowers pay their loans at a below-market fixed interest rate for a set period of time, after which the rate resets to the current market rate and continues to reset throughout the life of the loan. These loans can be useful for borrowers who plan to sell their homes or expect their salaries to increase before their monthly payments reset.
- **Option ARMs** that give borrowers the option of choosing from different types of payments each month, including minimum payment—which may be less than the monthly interest, resulting in negative amortization; interest-only payment; fully amortizing 30-year payment; or fully amortizing 15-year payment.
- **Balloon loans**, which let borrowers make low fixed monthly payments for a short period, after which the borrower must pay off the bulk of the loan in a lump sum.

A component of mortgage lending that has become more common in the era of relaxed underwriting standards is the use of stated income rather than traditional asset and income verification. Stated income allows borrowers to certify their income without documentation. Stated income can help borrowers who have varied income, unreliable income, or difficulty documenting their income, such those who are self-employed. However, stated income also may result in borrowers gaining approval for loans they cannot afford. Stated income loans are often called "liar loans" because they give borrowers, brokers, and lenders the opportunity to falsify income information to gain loan approval. According to the Office of the Comptroller of the Currency (OCC), in 2006 almost 50 percent of all subprime loans also were stated income loans.[11] Although stated income loans do not always include falsified information, the increased use of stated income in loan applications is cited frequently as a key factor in the rise of foreclosures due to borrowers who purposefully overstate their incomes and predatory lenders who intentionally inflate a borrower's income to increase their profit.

Today, many troubled loans are subprime hybrid ARMs, such as 2/28s and 3/27s, which allow borrowers to pay a low fixed interest rate for the first two or three years of the 30-year loan followed by regular interest rate adjustments for the remainder of the loan term. Homeowners with ARMs can experience significant "payment shock" after their interest rates adjust upwards, sometimes raising their monthly payments by as much as 40 percent. The new interest rate may be well over what the homeowner can comfortably afford, particularly in housing markets where home values have fallen or stagnated. Twenty-four percent of ARMs first originated in 2006 have negative home equity, which indicates that many of these homeowners are losing financial ground rather than building wealth.[12]

Borrowers

To help a lender determine borrowers' eligibility for a loan product and their likelihood of defaulting, the mortgage-lending industry classifies them into three categories based their credit history, rating, and income:

- **Prime** borrowers are deemed by lenders to be the most qualified borrowers based on credit worthiness and income. These borrowers are eligible for loans originated at the lowest interest rates.
- **Alternative-A** borrowers are those with unstable or unreliable incomes (e.g., business owners, doctors, lawyers, and others who are self-employed). Loans to Alternative-A borrowers carry a slightly higher interest rate than prime loans.
- **Subprime** borrowers have poor credit history, low incomes, or both and receive loans that carry the highest interest rates and may contain other fees and provisions designed to mitigate the lender's risk.

Today, subprime loans comprise just one-sixth of all mortgage loans but result in more than two-thirds of all foreclosures.[13] The subprime market has an important role in helping low-income families or those with blemished credit histories achieve homeownership. However, a combination of factors—rising interest rates, falling home values, economic hardship, lack of due diligence by borrowers and lenders, mortgage fraud, and predatory lending practices—has compounded, and many subprime borrowers have fallen behind on their mortgage payments. According to Freddie Mac, approximately one in 13 homes in the subprime market is at risk of foreclosure.[14]

Banks, Lenders, and Brokers
Several types of financial entities can originate mortgage loans in the United States, including national and state chartered banks; credit unions; thrifts, which take deposits and make residential and commercial loans; nonbank lending institutions; subsidiaries of banks and nonbank lenders; and mortgage brokers. The individuals who sit down with clients to negotiate and originate loans are loan originators who may work for either a mortgage broker or a mortgage lender. In some states, real estate agents also may act as loan originators. Less than one-third of all mortgage lenders are banks regulated by the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the National Credit Union Association (NCUA), the OCC, or the Office of Thrift Supervision (OTS).

Banks, which may be nationally or state chartered, are the most heavily regulated and examined mortgage lending entities in the United States and are subject to similar regulations whether they are state- or federally-chartered. Foreclosure poses a greater risk to banks than other lenders because banks assume the foreclosed property. When this happens, banks must dispose of foreclosed property, which becomes a liability on their books, generally at a financial loss. As a result, banks are more likely than other lenders to be willing to help borrowers find a way to avoid foreclosure.

Mortgage brokers—companies that act as a third-party liaison between a borrower and a lending institution—and nonbank lenders originate the majority of risky subprime loans. According to OTS, mortgage brokers originate between 70 and 80 percent of all subprime loans in the United States.[15] Mortgage brokers comprise about half of all mortgage lenders and are subject to various state regulations, but no federal regulations or licensing standards. Many licensed mortgage brokers are sole proprietors that act as loan originators. Other mortgage brokers are "net-branch" operations that allow individuals—who may or may not be individually licensed—to open branches by using the mortgage broker license of the parent company.[16] Some states do not require specific education or experience for loan originators whereas other states license mortgage broker offices but not loan originators.[17] Currently, 49 states license mortgage brokers and 35 license loan originators that are employed by mortgage brokers or lenders.[18]

In July 2007, the Conference of State Bank Supervisors (CSBS), a professional association of state officials responsible for chartering, supervising, and regulating the nation's 6,206 state-chartered commercial and savings banks, and the American Association of Residential Mortgage Regulators (AARMR) issued model guidelines for state mortgage regulators to use in examining lenders and brokers that offer nontraditional and subprime mortgages. Thirty-six states have adopted the nontraditional guidelines, and 29 states are working to adopt the subprime guidelines for upcoming examinations of state-licensed lenders. Additionally, beginning in January 2008, CSBS and AARMR will launch a nationwide mortgage licensing system to provide additional oversight of mortgage broker activity (see page 19).

Mortgage brokers work with borrowers by helping them to secure a loan with a lender. Brokers often work with several lenders and earn money by collecting fees from selling loans and preparing mortgage documents. Because brokers act as intermediaries who are not accountable for the long-term performance of a mortgage loan, they have an incentive to focus on the short-term profitability of a loan origination and make as many loans as possible. A 2003 study by AARP found that mortgage refinance loans originated by brokers to older borrowers were more than twice as likely to be subprime loans than were loans originated directly by lending institutions. Additionally, older borrowers with broker-originated loans were twice as likely to report that the broker initiated contact with them compared with borrowers with lender-originated loans.[19] These findings suggest that brokers, compared with lending institutions, are more aggressive in selling loan refinances and are more likely to seek out new borrowers.

The 50,000 nonbank lenders in the United States are overseen by the Federal Trade Commission (FTC). Nonbank lenders are financial institutions such as commercial financial companies, credit card companies, and insurance companies that do not hold depository accounts and include for-profit entities. These lenders do not undergo the same level of examinations required of banks. Because nonbank lenders are not subject to the same scrutiny as federally regulated depository institutions and can sell loans to the private secondary market, they too have an incentive to focus on short-term profitability.

Subprime Versus Predatory Lending

The emergence of the subprime lending industry has exacerbated mortgage fraud and predatory lending. It is important to emphasize that not all subprime lending is predatory, and predatory lending is only one component that is driving the rise of subprime foreclosures. However, predatory lending is much more common within the subprime loan market than the prime market.

Predatory lending activity is difficult to quantify because of the complexity of loans and the involvement of multiple parties including lenders, appraisers, and mortgage brokers. Though it may be challenging to isolate predatory practices, there are common indicators that suggest a loan is predatory (see box, below). Predatory loans are often high-interest, high-fee, and riddled with terms that strip the borrower of home equity. Lenders may fail to disclose egregious loan terms, misrepresent a loan, or execute a "bait-and-switch" where the terms of the loan at the closing are different from the terms the borrower originally approved. Predatory loans also may include products without the borrower's knowledge and ignore escrows for taxes and insurance, requiring borrowers to pay them in a lump sum. Additionally, some brokers or lenders may work with home appraisers and inspectors to inflate the value of the home in an effort to saddle a borrower with a larger loan. The loan originator will then provide kickbacks to the other parties involved in inflating the loan.

Common Earmarks of Predatory Loans

Yield-spread premiums give a bonus to brokers for assigning a borrower an interest rate for a mortgage loan that is above the rate for which the borrower is eligible.

Mandatory arbitration limits a borrower's right to contest abusive loan terms in the future.

Excessive fees significantly raise the price of loan origination and loan transactions.

Excessive/abusive prepayment penalties saddle a borrower with a large fine for paying or refinancing a loan before the maturation of the original loan. Not all prepayment penalties are abusive; however, characteristics of abuse include penalties that represent an excessively high percentage of the mortgage or that continue throughout the life of a loan.

A common predatory action is to put pressure on a borrower to refinance, or "flip," a loan repeatedly. Flipping helps the lender or broker collect additional fees, often while saddling the borrower with higher monthly payments.

Lenders and brokers also may sell exotic products, such as balloon loans and ARMs, to borrowers under the guise of traditional loans. An exotic loan that is otherwise legal may be considered predatory if a lender fails to consider a borrower's ability to repay the loan after monthly payments increase to their maximum amount or if the lender misrepresents or purposefully fails to disclose loan terms, such as maximum monthly payments and interest rate adjustments. When exotic loans are paired with abusive fees and penalties and other predatory tactics, the results can be devastating to a borrower.

For example, in testimony before Congress, FDIC Chairwoman Sheila C. Bair noted that subprime borrowers have a higher housing cost burden than prime borrowers. Whereas the average prime borrower spends approximately 17 percent of his or her net income on mortgage and other housing costs, the average subprime borrower spends nearly 37 percent of his or her net income on these expenses. This percentage is likely to increase as more subprime borrowers with ARMs see their rates adjust upwards.[20] When borrowers devote large percentages of their monthly incomes on housing costs, they must sacrifice spending in other areas such as food, clothing, and retirement. Therefore, when these subprime borrowers receive exotic loans as a result of predatory practices, they are especially likely to suffer serious financial consequences.

Predatory lenders often target specific neighborhoods, which helps to explain why foreclosures tend to be clustered together. A borrower who lives in a high-minority area is 35 percent more likely to receive a subprime loan with a prepayment penalty than a borrower who lives in a predominantly white neighborhood.[21] Predatory mortgage lenders tend to prey on low-income, minority, and elderly homeowners. In a 2006 analysis, CRL found that African Americans and Latinos were 29 percent and 40 percent more likely, respectively, to have high-cost subprime fixed-rate loans than white borrowers with similar characteristics.[22]

Other likely targets of predatory lenders include women, particularly single mothers and elderly women, and borrowers residing in rural communities. Rural borrowers are vulnerable to predatory lenders because fewer financial institutions serve rural areas than urban areas. Rural communities in the South and Midwest with high poverty and minority concentrations are the most likely to receive loans with high interest rates.[23]

Predatory Tactics

A May 2007 report from National Public Radio featured former employees of what was once the nation's largest subprime lender explaining the tactics they used to originate new and profitable loans. Loan originators described making overt misrepresentations of loan terms and concealing adjustable rates and prepayment penalties. Loan originators often used bait-and-switch tactics to trick clients into signing loan documents with abusive terms. One employee placed papers containing fixed interest rate terms at the top of a stack of loan papers at closing. Beneath those papers, were documents negating the fixed rate and installing an adjustable rate. In 2006, 49 state attorneys general won a lawsuit against the company, but the settlement funds are unlikely to bring much financial relief to the 240,000 victims.

Foreclosure's Impact on States, Neighborhoods, and Families

When a family loses its home, the loss devastates the family's financial stability and the repercussions ripple throughout the community, weakening neighborhood vitality and hurting the local economy. Foreclosed families lose their home and their home equity. They may face additional financial burdens such as fees, penalties, taxes on forgiven debt, and the costs associated with moving to a new location. Moreover, foreclosure ruins a borrower's credit, making it difficult to access and afford stable and safe housing. A 2004 study found that it can take whites 10.7 years, African-Americans 14.4 years, and Hispanics 14.3 years to purchase a new home after leaving homeownership.[24] Foreclosed borrowers are often forced to move in with family members or find landlords willing to rent to tenants with poor credit. Foreclosure may even force some former homeowners into homeless shelters.[25]

Renters are also affected by foreclosure. When an owner of a multi-family housing unit faces foreclosure, renters of that unit also may face an uncertain future. Officials of two counties in the Minneapolis, **Minnesota** area estimate that between 43 percent and 45 percent of their first quarter foreclosures in 2007 were rental properties.[26] The recent housing slump also has contributed to the number of developers at risk of foreclosure due to weak sales. In **North Carolina**, Governor Mike Easley signed a new law, HB 947, in August 2007 to protect tenants living in foreclosed properties, due to the increase in commercial foreclosures in the state.[27] The law requires that certain tenants receive notice of foreclosure proceedings and the opportunity to cancel rental agreements.

Foreclosure harms neighborhoods and communities in a variety of ways. In 2005, the Woodstock Institute found that each foreclosure in a neighborhood lowers the property value of surrounding homes by 0.9 to 1.136 percent on average.[28] A foreclosure in a low- to moderate-income neighborhood causes property values to drop even more. The more foreclosures that occur in a single neighborhood, the more surrounding property values decline. An April 2007 report from the U.S. Senate Joint Economic Committee estimates that a single foreclosure can cost as much as $80,000 in terms of loss to lenders, investors, and the community at large.[29]

Neighborhoods that experience multiple foreclosures face other consequences. Vacant homes often deteriorate due to lack of maintenance and can attract crime. Other homeowners have a difficult time selling their homes when they must compete against steeply discounted foreclosed homes sold or auctioned by banks. Additionally, municipalities, neighborhoods, and local schools lose revenue previously generated by property taxes and county service fees from water, gas, and electricity.

In one zip code in Detroit, **Michigan**, an estimated one in three subprime loans originated between 2002 and 2006 are now on the brink of or are already in foreclosure. In 2006, homeowners in that zip code took out more than $6 million in subprime loans, which comprised between 65 percent and 70 percent of the total number of loans originated in that zip code. As a result, neighborhoods experiencing a high number of foreclosures are starting to decline as troubled homeowners abandon their homes.[30] In **North Carolina**, more than 20 percent of homes have foreclosed in 35 starter home developments in Mecklenburg County, where overgrown lawns and empty houses have become common.[31]

State Actions to Address Foreclosures

In light of the recent wave of foreclosures, governors have launched initiatives aimed at helping troubled homeowners by blocking foreclosure rescue scams, connecting borrowers to counseling and resources, facilitating loan workouts and refinances, and slowing the foreclosure process to give homeowners time to save or sell their homes. States also have moved to prevent future foreclosure crises by banning predatory lending practices, tightening regulation of mortgage brokers and loan originators, criminalizing mortgage fraud, and educating homebuyers. The following sections provide an overview of the state role in mortgage market oversight and detail state actions to help troubled homeowners and prevent future foreclosures.

The State Role in Mortgage Market Oversight

States regulate nonbank lenders and mortgage brokers, which originate collectively more than 50 percent of all mortgage and refinance loans. Nonbank lenders are also overseen in part by FTC and HUD. The majority of subprime loans are made through nonbank lenders and brokers, and these loans have a higher failure rate than subprime loans originated through national- and state-chartered banks.

Federal laws such as the Home Ownership Equity Protection Act seek to ensure that lenders accurately represent loan products, and the Home Mortgage Disclosure Act requires lenders to submit data to the FDIC each year to help the federal government identify questionable lending practices. However, current oversight and regulation does not fully protect consumers from predatory lender as a result of the expansion of the subprime market, the rapid growth of mortgage broker and nonbank lending activity in recent years, and the proliferation of nontraditional and complex mortgage products. In response, states are strengthening statutes and regulations that govern mortgage brokers and certain nonbank lenders, although a recent Supreme Court decision upheld federal preemption over the state regulation of nonbank mortgage subsidiaries of nationally chartered banks.

The Impact of Watters v. Wachovia Bank, N.A.

In the 2006 Supreme Court case of *Watters v. Wachovia Bank, N.A.* {127 S. Ct. 1559 (2007)}, the Court held that federal banking law preempts certain state regulation of nonbank subsidiaries engaged in mortgage lending. The court's ruling hampers the ability of states to apply state laws governing examination, supervision, and regulation of mortgage lending to a nonbank operating subsidiary of a federally chartered bank.

States are well-suited to reach out to troubled borrowers to help connect them with the resources necessary to avoid foreclosure. Because states understand their own residents and the challenges they face, state policymakers can tailor initiatives to meet the needs of their citizens. This is particularly true in the area of mortgage finance regulation. In considering laws and regulation to prevent future foreclosures, state policymakers are well situated to strike an effective regulatory balance that protects homeowners without cutting off credit access to low-income borrowers who could benefit from homeownership.

Helping Troubled Homeowners

In congressional testimony, the chairman of Freddie Mac suggested that policymakers focus their efforts on low- and moderate-income and minority families, as these borrowers account for about half of all subprime borrowers and may be disproportionately hurt by the rising number of foreclosures.[32] Taxpayers are likely to balk at a broad bailout of troubled borrowers, and some borrowers may simply not be financially ready to sustain homeownership, even with state assistance. Some states are trying to focus their statutory and regulatory efforts only on those borrowers who were the victims of fraud or predatory practices.

As a critical first step, several states have launched task forces and investigations aimed at identifying the scope of the foreclosure crisis in their states. A task force can help to pinpoint the problem and develop useful recommendations for helping the families most at risk of losing their homes while creating solutions for preventing new foreclosures.

For example, in June 2007, **Maryland** Governor Martin O'Malley launched the Maryland Homeownership Preservation Task Force. It is charged with examining the subprime market in the state and creating recommendations for preventing future foreclosures. Specifically, the task force will gather data on the current state of housing in Maryland, including existing laws and regulations. The task force will use this information to create programs that minimize the number of foreclosures and develop outreach, counseling, and education to support homeowners and prevent future foreclosures. The task force also will evaluate financial resources to determine how best to assist families in need of workouts, refinances, and other financial assistance.[33]

New York Governor Eliot Spitzer launched a task force in May 2007 that similarly aims to identify communities at risk of multiple foreclosures, develop financial assistance programs to aid troubled borrowers, and launch a statewide outreach and education campaign. The task force also is charged with proposing legislative and regulatory reforms to strengthen consumer protections and creating a system to better identify predatory lenders and ensure that those lenders are pursued by law enforcement.[34]

Other governors, including **Arizona** Governor Janet Napolitano, **Connecticut** Governor Jodi Rell, and **New Mexico** Governor Bill Richardson created similar task forces to serve as starting points for identifying the extent of subprime foreclosures in their states and recommending strategies for keeping families in their homes.[35] **Indiana's** general assembly has created an interim study committee to address mortgage lending and foreclosure issues.[36] **Michigan** Governor Jennifer Granholm has directed the Michigan Office of Financial and Insurance Services and the Michigan State Housing Development Authority to examine the current problems facing consumers with subprime loans and develop initiatives to improve industry oversight and assist borrowers who are facing foreclosure.[37] **Ohio** Governor Ted Strickland's foreclosure task force, created in March 2007, released findings September 2007, which include recommendations on:

- Encouraging borrowers to get help early;
- Expanding housing counseling and intervention services;
- Working with lenders and servicers to maximize foreclosure alternatives;
- Providing loan refinance and restructure options to homeowners, including tax forgiveness on loan readjustments;
- Improving the foreclosure process by increasing borrower access to legal counsel, encouraging dispute resolution, and expediting property transfer; and
- Helping communities recover from foreclosure.[38]

Once a state has decided that action is needed, there are several options available for assisting troubled borrowers, including:

- Stopping foreclosure scams;
- Connecting borrowers to counseling and resources;
- Encouraging workouts and refinances; and
- Slowing the foreclosure process.

Stopping Foreclosure Scams

States have seen a rise in foreclosure rescue scams, where people purporting to help troubled homeowners trick them into relinquishing their titles or selling at a price lower than they would receive on the market. Victims of foreclosure rescue scams—often the same people susceptible to predatory lenders—lose even more than they would under normal foreclosure circumstances. State laws to protect homeowners from such fraudulent activity can help to prevent scammers from exacerbating the already difficult and costly process of foreclosure.

For example, **Illinois** passed the Mortgage Rescue Fraud Act (SB 2349) in June 2006 to protect troubled borrowers from fraudulent foreclosure rescue scams. The law requires that any person who seeks to assist a homeowner at risk of foreclosure fully disclose in writing the terms of services and all associated costs. The law also gives troubled homeowners the option to cancel services with a mortgage rescuer at any time. The law aims to require mortgage rescuers to fulfill their obligation or purchase the homeowner's home for a high percentage of the home's value.

In July 2007, **New Hampshire** Governor John Lynch signed legislation that regulates foreclosure rescuers and establishes criminal and civil penalties for scammers.[39] HB 365 requires that foreclosure consultants provide homeowners a written contract fully disclosing the terms of any foreclosure rescue agreement and including associated fees. The document must be signed by both the homeowner and the consultant and be notarized. Additionally, the contract must include a document explaining the homeowner's right to cancel the agreement. The law also prohibits foreclosure rescuers from gaining power of attorney from a homeowner.

Indiana SB 0390, signed into law in May 2007, establishes new foreclosure notice requirements and protects homeowners from foreclosure rescuers by giving homeowners the ability to rescind contracts with foreclosure rescuers. The legislation further requires the Indiana Housing & Community Development Authority (IHCDA) to maintain a list of nonprofit, certified foreclosure consultants and forward this list to the attorney general on a regular basis.

Connecting Borrowers to Counseling and Resources

Foreclosure counseling can help troubled homeowners to understand their options and take action to save their homes before it is too late. Additionally, counseling can help connect borrowers to resources they need to restructure or refinance their existing loans or manage foreclosure if foreclosure is inevitable. **Indiana** Governor Mitch Daniels signed HB 1753 in May 2007 to provide free mortgage foreclosure counseling and education to troubled homeowners. Under the bill, the state gives the Indiana Housing and Community Development Authority (IHCDA) the option to establish a statewide mortgage foreclosure hotline to help connect homeowners to trained counselors. Additionally, homeowners in the state who receive a foreclosure notice will also receive information on foreclosure prevention resources available to them through IHCDA.

Several states have developed initiatives to help link homeowners to counseling and resources. Foreclosure hotlines, operated by states and nonprofits, have emerged as an effective way to provide troubled borrowers with the help they need. For example, **Colorado** launched a foreclosure prevention hotline in October 2006 through a joint effort by the state and industry and community groups.[40] The hotline connects at-risk borrowers to a local housing counseling agency so they can receive professional advice about avoiding foreclosure. According to the Colorado Division of Housing and Brother's Redevelopment Inc., as of April 2007 approximately four of five callers had avoided foreclosure.[41] Similarly, **Connecticut** Governor Jodi Rell has established a mortgage foreclosure assistance hotline for state residents facing foreclosure. Callers receive advice, guidance, information, and materials to help them address their mortgage problems.[42] States, such as **Delaware**, are also referring troubled borrowers to the Homeownership Preservation Foundation's national Homeowner's HOPE Hotline, 800-995-HOPE, for financial counseling.[43]

Outreach is an important component of ensuring that troubled homeowners receive help. According to the NeighborWorks America, many families wait until they have missed several payments before seeking help. In fact, in 2006, 62 percent of callers to a national foreclosure-prevention hotline were already more than two months behind on their mortgage payments.[44] By then, it is more difficult to work out a solution between the borrower and the lender. Lending institutions, community organizations, and federal bank regulators have urged borrowers to contact their loan servicers as soon as they begin having difficulty making payments. Governors can help lead this charge by targeting outreach toward communities most at risk of multiple foreclosures. As previously noted, **Maryland** and **New York** have charged their task forces with developing outreach campaigns.

NeighborWorks America, in partnership with the Ad Council, has launched a national advertising campaign to raise consumer awareness about rising foreclosures. The campaign urges borrowers that may have trouble paying their mortgage loans when their interest rates reset to contact the national HOPE hotline for free foreclosure prevention counseling. The campaign will work with state and local governments to tailor and target ads to particular communities, and keeps a list of localized print ads by state. Television, print, radio, and online advertisements are available to view and order on the campaign website.

Encouraging Workouts and Refinances

The most desirable outcome for all parties involved in a troubled loan is to avoid foreclosure and the associated costs and consequences. Policymakers may find that local and state banks, which suffer in terms of lost time and money when their borrowers enter foreclosure, are natural partners in developing efforts to help families stave off foreclosure. Particularly in the current climate of restricted credit access as a result of market response to subprime defaults, states are facilitating foreclosure solutions by doing the following:

- Asking troubled borrowers to contact their loan servicers;
- Encouraging lenders and loan servicers to work with troubled borrowers; and
- Offering financial assistance to at-risk homeowners to help them refinance out of high-cost loans with prepayment penalties or originate safe home refinance loans to borrowers through a state loan program.

Loan workouts allow borrowers to adjust the terms of their mortgage loans to make the loans more affordable. For example, some borrowers may need to extend the life of their loans from 15 years to 30 years or from 30 years to 40 years. Lenders also may agree to forgive part of the interest due or waive certain fees or penalties that resulted as part of the initial delinquency; however, forgiven debt can be a tax liability for the borrower (see paragraph on "Short Sales," page 16). A significant barrier to loan workouts is the securitization process. Some loan pools in the secondary market limit the percent of bonds within that pool that may be modified. As such, borrowers and foreclosure counselors may have a difficult time negotiating a workout.

Refinancing is another way to help borrowers escape troubled loans. For a borrower holding a loan with an unaffordable interest rate or one that contains equity-stripping fees and penalties, refinancing may be the best solution to help the borrower obtain a loan with safe and affordable terms. However, refinancing has become difficult for subprime borrowers because of recently tightened loan restrictions that preclude borrowers with poor credit history and loan delinquencies from gaining access to new credit.

Encouraging Troubled Borrowers to Contact Their Loan Servicers—States have several options for helping borrowers obtain loan workouts and refinances. First, states can encourage borrowers to contact their loan servicers. A loan servicer is a company that collects, manages, and reports loan payments after the loan has been approved and dispersed. Lenders that originate loans and investment banks that purchase loans in the secondary market typically hire a loan servicing company to manage the loan and work with the borrower. In **Montana**, the Montana Board of Housing provides funding for foreclosure prevention counseling to help borrowers negotiate with loan servicers by evaluating options such as working out an agreement with the loan servicing company, analyzing assets that may be used to bring a loan current, budgeting, or arranging a short sale or deed in lieu of foreclosure.[45]

Second, states may refer borrowers to Fannie Mae and Freddie Mac for assistance with loans these GSEs have purchased or guarantee. Fannie Mae and Freddie Mac then direct servicers to engage in loss mitigation efforts and workouts. Although the GSEs function mainly in the prime mortgage market, Freddie Mac has announced a $20 billion commitment to purchase subprime mortgages with a product designed to limit payment shock by offering reduced adjustable rate margins, longer fixed-rate terms, and longer reset periods.[46] The combined efforts of Freddie Mac, Fannie Mae, and the Federal Housing Administration (FHA) could provide relief for an estimated 50 percent of borrowers with troubled loans.[47] States can encourage borrowers to determine whether they are eligible for a workout through Fannie Mae or Freddie Mac or can refinance with an FHA-insured loan.

Encouraging Lenders and Loan Servicers to Work with Troubled Borrowers—Governors can encourage lenders and loan servicers to work with borrowers to keep them in their homes. For, example, in April 2007, **Massachusetts** Governor Deval Patrick encouraged state banking officials to renegotiate mortgage terms to help troubled borrowers stay in their homes.[48] On September 5, 2007, **California** issued a notice to loan servicers subject to California law, encouraging them to work with financially stressed borrowers to provide loan workouts. Workout arrangements may include modified loan terms or converted loan products with payments that are easier for the borrower to manage. The notice also encourages servicers to contact at-risk borrowers early to determine their risk of loan default.[49]

In September 2007, attorneys general from 10 states announced the formation of a task force to encourage loan servicers to provide workouts for troubled borrowers. The task force, which includes representatives from **Arizona**, **California**, **Colorado**, **Illinois**, **Iowa**, **Massachusetts**, **New York**, **North Carolina**, **Ohio**, and **Texas**, has invited mortgage servicing companies to collaborate on finding ways to help subprime borrowers obtain workouts and creating long-term solutions for troubled borrowers.[50]

States also can encourage lenders to allow "short sales" to help borrowers for whom foreclosure is inevitable cut their losses and keep their credit intact. Through a short sale, borrowers who owe more on a mortgage loan than their home is worth may sell their homes for whatever they are worth on the market. The lender in turn accepts the amount of the sale as payment in full for the loan. However, states are finding that short sales have tax implications due to the debt that the lender forgives. Currently, the forgiven debt is treated as income and is subject to income tax, which can result in a large tax bill for the former homeowner. On the other hand, through a short sale, the borrower avoids having a foreclosure appear on his or her credit report, which makes it easier to find safe and decent housing after the sale of the home. Borrowers considering short sales must therefore consider the pros and cons of such a transaction.

<u>Offering Financial Assistance to At-Risk Borrowers</u>—States are developing financial programs to help borrowers avoid foreclosure. For example, **Ohio** has launched the <u>Opportunity Loan Refinance Program</u> to help borrowers refinance high-cost mortgages. In April 2007, the state announced that it would sell up to $100 million of taxable bonds to make new home loans to eligible borrowers. Eventually, the state may sell up to $500 million in bonds. Mortgage payments will pay off the bonds. The Opportunity Loan Refinance Program website lists approved lenders that borrowers can use to start the refinancing process. The program targets borrowers with high-cost subprime loans, particularly subprime ARMs, and helps them refinance to a lower-interest fixed-rate loan before they become delinquent on their mortgage payments. Families with up to 125 percent of the area median income may apply for the program. The program has no maximum loan amount or appraisal value, but it does require a new home appraisal before refinancing. The loans cover up to 100 percent of the appraisal value, and borrowers may also receive a second mortgage for up to 4 percent of the appraisal value to cover closing costs and any prepayment penalty attached to the original loan. The Ohio Housing Finance Agency also works with Fannie Mae to secure underwriting waivers that help to qualify some borrowers who would otherwise be ineligible for a traditional mortgage loan refinance.

Similarly, **Maryland** borrowers can take advantage of <u>"Lifeline" Refinance Mortgage Program</u>, a program launched in 2006 that allows homeowners saddled with rising adjustable interest rates to refinance their loans through one of the approved lenders listed on Maryland's Department of Housing and Community Development website. The state also is working with lenders to find alternatives to prepayment penalties for borrowers seeking to refinance. Once a borrower refinances into a new loan, the lender bundles that loan with others and sells the loan package to the Maryland Department of Housing and Community Development, which makes the purchase using cash from a bond issue. Borrower interest on the new loans will go to the state for paying off the bonds. Borrower eligibility is determined by maximum household income limits, maximum appraised value limits, loan-to-value limits, and credit limits. Borrowers with credit scores below 600 may not be approved for a loan but are not automatically disqualified.

Additionally, borrowers with credit scores below 680 are required to go to homeownership counseling.

In July 2007, **New York** launched a similar foreclosure prevention fund. New York's Keep the Dream fund sets aside $100 million to help between 500 and 700 families refinance out of high-risk loans.[51] As part of their participation in the program, borrowers must take a homeowner education course prior to loan origination and participate in early delinquency intervention counseling should they get behind on payments to their refinanced mortgage. Also in July, **Massachusetts** created a $250 million foreclosure prevention fund with the help of $190 million from Fannie Mae. The remaining cost of the program is covered by a $60 million sale of bonds. The program targets low-income victims of predatory lending and will accept borrowers who are up to 60 days delinquent on their mortgages if the cause of their delinquency is an interest-rate reset. **Delaware's** Emergency Mortgage Assistance Program (DEMAP), **Pennsylvania's** Refinance to an Affordable Loan (REAL) Program, and **Montana's** HomeOwnership Network offer similar services to borrowers at risk of foreclosure.

In 2006, **Michigan** Governor Jennifer Granholm announced that the Michigan State Housing Development Authority and the Mortgage Guaranty Insurance Corporation would provide lower mortgage insurance premiums and payment assistance to eligible borrowers who become involuntarily unemployed. This program provides up to $1,500 or the total amount of the mortgage payment, whichever is less, for a period of up to six months to help troubled borrowers avoid foreclosure.[52]

Slowing the Foreclosure Process

To slow the wave of foreclosures, some states are considering moratoriums on current foreclosures or waiting periods on future foreclosures. For instance, in April, **Massachusetts** Governor Deval Patrick launched a 60- to 90-day delay on certain foreclosure proceedings.[53] He directed the Massachusetts Division of Banks to work on a case-by-case basis to delay for up to two months foreclosures on borrowers who have filed consumer complaints. This waiting period gives borrowers time to settle their debts, seek a loan workout, or sell their property, thus mitigating the financial damage of foreclosure. **Louisiana** Governor Kathleen Babineaux Blanco has encouraged lenders either to wait before initiating foreclosure on borrowers or pursue other options.

Foreclosure moratoriums have potential downsides that states may want to consider. Some housing experts argue that delaying foreclosure can be problematic because the foreclosure process is already lengthy, lasting anywhere from 30 days to 19 months depending on state law, and typically does not begin until loans are 60 to 120 days delinquent. Therefore, further delay may be costly to borrowers because a borrower's debt continues to accumulate if he or she is unable to obtain a workout, sell the home, or repay the debt. Finally, delays increase the time that properties stay vacant, which can have a negative impact on the value of surrounding homes.

Preventing Future Foreclosures

In addition to helping borrowers in danger of losing their homes, governors have focused attention on the laws and regulations surrounding the mortgage lending market that left the door open for predatory lending and mortgage fraud. As a result, many states have passed legislation aimed at:

- Banning predatory lending practices;
- Adopting regulatory guidelines for subprime and nontraditional mortgage products;
- Tightening regulation of mortgage brokers and loan originators;
- Increasing criminal penalties for mortgage fraud, enforcing existing lending laws, increasing funding for supervision, and pursuing violators; and
- Educating homeowners.

Banning Predatory Lending Practices
Currently, more than 30 states have some form of an antipredatory lending law, and many other states are considering similar laws. For instance, many states ban abusive prepayment penalties, which can prevent borrowers from refinancing out of failing mortgage loans. However, some states are finding that their laws do not cover all of the practices that are trapping borrowers in failing loans today. In seeking to curb predatory lending, it is important that states strike a careful balance between stopping bad lending practices and ensuring that lenders still have the ability to use financial tools that could be beneficial for offering credit to low-income borrowers and those with less than stellar credit.

In response, several states have passed new legislation designed to curb predatory lending practices. For example, in August 2007, Governor Mike Easley signed new legislation to strengthen **North Carolina**'s antipredatory lending law.[54] In 1999, the state adopted the country's first antipredatory lending law, but rapid changes in the lending market since the adoption of that law prompted the state to add additional consumer protection from abusive lenders. HB 1817:

- Limits mortgage brokers' ability to collect yield-spread premiums and charge prepayment penalties;
- Requires lenders to consider the ability of borrowers to repay the loans; and
- Protects homeowners from abusive mortgage servicing companies that misapply mortgage payments, charge illegal fees, and mishandle escrow accounts.

On June 11, 2007, Governor John Baldacci of **Maine** signed LD 1869 to protect Maine homeowners from predatory lending.[55] The legislation, which received bipartisan support as well as support from local consumer and professional organizations, prohibits mortgage loans from accelerating the homeowner's debt, such as through negative amortization (i.e., when mortgage debt increases because the homeowner is not required or not permitted to make full payments on interest and principal) and bans mandatory arbitration clauses. The legislation also bans loan flipping, caps lender fees, and requires lenders to consider a borrower's ability to repay a loan prior to origination. The bill additionally mandates homeownership counseling for subprime borrowers.

On May 14, 2007, **Minnesota** Governor Tim Pawlenty signed SF 988 to strengthen consumer protections against predatory lending practices. The legislation gives borrowers recourse to bring suit against predatory lenders and collect attorney's fees if they win their suit. Specific provisions of the bill require lenders to originate adjustable loans only if the borrower can afford the adjusted rate. The law also caps loan fees, bans negative amortization, prohibits prepayment penalties, requires lenders to include escrow in stating the cost of a loan to a borrower, and bans loan flipping. Additionally, the legislation prohibits the refinancing of a "special mortgage"—a mortgage with a nonstandard payment terms, such as income-based payments or no- or low-interest, that is provided, serviced, or subsidized by state, local, or tribal government or a nonprofit organization—unless special loan counselors certify that they counseled the borrower on the advisability of refinancing.

In May 2007, **Hawaii** Governor Linda Lingle signed three pieces of legislation (SB 1400, HB 1306, and HB 1336) designed to give specific protections to the state's senior citizens against solicitations for fraudulent mortgage investments.[56] The new laws require financial institutions to report immediately suspected fraudulent activity against customers ages 62 or older; create additional penalties against people convicted of securities violations against customers ages 62 or older; and levy additional fines on mortgage brokers who enter into mortgage agreements with senior citizens resulting in loss home equity or in the loss of their homes altogether.

In July 2006, **Rhode Island** Governor Don Carcieri signed the Home Loan Protection Act (S 2851) to better protect borrowers from predatory mortgage lending practices and the Madeline Walker Act (S 2092) to prevent foreclosure over small tax debts and enact other measures to improve regulations on the mortgage foreclosure industry. The Home Loan Protection Act prohibits loan flipping and mandatory arbitration and attempts to eliminate incentives for lenders to make predatory loans by creating "assignee liability" for secondary parties that purchase high-cost home loans. In June 2007, the state legislature clarified the assignee liability provision to ensure that only borrowers acting in an individual capacity may assert a claim against the assignee. Assignee liability makes the loan purchaser liable if the borrower brings suit against the original creditor. By making the secondary purchaser liable for borrower claims, the secondary purchaser has an incentive to ensure that the loans it buys comply with the law, which shifts market demand to safe and affordable loans. The act also gives families access to mortgage counseling and education.

Ohio's Homebuyer Protection Act (SB 185), passed in June 2006, prohibits mortgage loan originators, mortgage brokers, and nonbank lenders from engaging in unfair and deceptive lending practices. The Homebuyer Protection Act bans:

- Originating a loan knowing that the borrower will not be able to repay;
- Repeatedly refinancing a loan when there is no benefit for the borrower;
- Taking advantage of illiterate borrowers and borrowers with mental deficiencies;
- Financing credit, life, disability, or unemployment insurance premiums or any debt collection agreements as part of a loan, unless those premiums are paid monthly;
- Charging multiple late fees on a single late payment; and
- Enforcing a prepayment penalty on first lien mortgages of less than $75,000.[57]

Adopting Regulatory Guidelines for Subprime and Nontraditional Mortgage Products

Many states are working to adopt regulatory guidelines for mortgage brokers and mortgage companies not affiliated with a bank holding company or insured financial institution. In July 2006, CSBS and AARMR developed guidance to assist state regulators in clarifying how mortgage brokers and state-regulated mortgage companies can offer nontraditional mortgage products in a way that ensures borrowers understand the risks associated with these products.[58] On June 29, 2007, CSBS, AARMR, and the National Association of Consumer Credit Administrators (NACCA) issued a Subprime Statement to clarify how mortgage brokers and state-regulated mortgage companies can offer subprime loans in a way that clearly discloses to borrowers the risks they may assume by using such products.[59] The goal of the nontraditional mortgage guidance and the subprime statement is to help state regulators promote consistent regulation of the mortgage market. The guidance parallels nontraditional mortgage guidance and a subprime statement issued by the OCC, FRB, FDIC, OTS, and NCUA in October 2006 and June 2007.

Additionally, in July 2007, CSBS and AARMR issued model guidelines for state mortgage regulators to use in examining lenders and brokers that offer nontraditional and subprime mortgages.[60] Since 2006, 36 states have adopted the nontraditional guidelines, and 29 states are working to adopt the subprime guidelines for upcoming examinations of state-licensed lenders.

Tightening Regulation of Mortgage Brokers and Loan Originators

States are implementing licensing standards for individual loan originators that include education requirements, testing, and criminal background checks. Currently, 35 states require licensing or registration of individual loan originators. States also are enacting rules that place a fiduciary responsibility on individual loan originators to act in the best interest of the borrower.

Moreover, states are seeking to impose regulations on brokers, lenders, and loan originators by requiring strict licensing standards and working with other states to ensure that companies and individuals that have engaged in fraudulent activity in the past cannot relocate to a new state and continue such activity. To aid this effort, CSBS has been working with AARMR to develop a national mortgage licensing system. The goal of this initiative is to increase the efficiency and effectiveness of the mortgage market by improving supervision and accountability of mortgage lending professionals. As of July 2007, 35 states had announced their intent to participate in the licensing system, which will launch in January 2008. The system will allow consumers to access information on licensed brokers, lenders, bankers, and mortgage companies, including license status and a history of public enforcement actions. The system will assign each loan originator a unique identifier that can be used to track companies and people across states over time.

To prevent fraudulent lending activity in her state, in July 2007, **Alaska** Governor Sarah Palin signed legislation to require background checks, licensing, and competency testing of mortgage lenders, brokers, and originators. HB 162 will become active on March 1, 2009, and will be the first Alaskan law to regulate the lending industry. The bill's aim is to curb predatory lending by increasing lender accountability and preventing lenders, brokers, and loan originators who have engaged in predatory practices in other states from practicing in Alaska. .

On June 1, 2007, **Colorado** Governor Bill Ritter signed a package of legislation aimed at curbing the 37,000 foreclosures the state expects to see by the end of 2007.[61] The legislation, which includes HB 1322, SB 85, SB 203, SB 216, and SB 249, primarily focuses on increasing mortgage broker regulation and oversight and includes provisions for the following:

- Expanding individual mortgage broker loan originator registration requirements;
- Preventing mortgage broker loan originators from influencing the judgment of a real estate appraiser in an effort to inflate the value of a house or property;
- Requiring that mortgage broker loan originators be licensed and adhere to specific training, testing, and education guidelines;

- Prohibiting mortgage broker loan originators from engaging in specific activities, including fraud and misrepresentation, and revoking licenses from brokers who violate these rules;
- Imposing a statutory duty of good faith and fair dealing upon mortgage broker loan originators; and
- Directing the Colorado Division of Insurance to provide a statistical report of trends within the state's mortgage market and complaints against mortgage broker loan originators.

In June 2007, **Florida** Governor Charlie Crist signed SB 1824 to strengthen regulations on mortgage brokers and individual loan originators, including new education requirements and fines for loan originators that engage in fraudulent lending activity. Under the new law, mortgage brokerages must provide consumers full disclosure of all parties involved in the mortgage, and the state's Office of Federal Regulation is fully authorized to enforce consumer protections with regard to mortgages.

In April 2007, **Minnesota** Governor Tim Pawlenty signed SF 809 to require mortgage brokers to act in a borrower's best interest. The legislation tightens broker regulations, including prohibiting mortgage brokers from unreasonably delaying the processing of a mortgage loan application or closing; misleading borrowers or misrepresenting the terms or a loan; working with home appraisers to inflate the value of a home appraisal; making a loan with the intent that the borrower will be unable to repay; and originating a subprime loan to a borrower who qualifies for a prime loan.

Increasing Criminal Penalties for Mortgage Fraud and Pursuing Violators
Providing the funding and staff resources necessary to provide regulatory oversight, enforce lending laws, and pursue violators is key to reducing fraudulent lending practices and protecting homeowners. For example, **New York** has updated assessment of mortgage brokers to provide sufficient funding resources for regulatory supervision. **Washington** implemented a law to provide a steady stream of funds for investigating and prosecuting mortgage fraud by adding an additional fee of $1 to every real estate recording. Collected fees are forwarded to a special agency fund, which is earmarked for the prosecution of mortgage fraud. The fund accumulates approximately $1 million per year.[62] **Massachusetts** has significantly increased the number of examiners and consumer assistance specialists to improve supervision.[63] **Pennsylvania** has doubled the number of examiners who focus on nonbank lenders and mortgage brokers.[64]

Other states have passed legislation to improve enforcement of state lending laws. In **Illinois**, Governor Rod Blagojevich combined four state agencies to improve the enforcement of mortgage lending laws from start to finish. The consolidated agency, the Illinois Department of Financial and Professional Regulation, pursues lenders as well as realtors and others involved in the mortgage origination process through the state's Mortgage Fraud Task Force. The Mortgage Fraud Task Force has successfully disciplined more than 90 companies and individuals, with actions ranging from fines to revoking a company's license to do business in Illinois. Recently, the task force uncovered one of the largest fraud schemes in state history, "Operation Flip-Flop." The scheme centered in the Chicago area and involved more than 100 properties.[65] In **Ohio**, the Homebuyer Protection Act gives the state's attorney general enforcement authority over abusive lending practices committed by loan originators, mortgage brokers, and nonbank lenders.[66] The

California Department of Corporations (DOC) has a long history of taking action against predatory lenders. Specifically, the DOC has worked to oversee mortgage lenders and pursue those that engage in fraudulent activity. If a lending company unexpectedly closes, the DOC takes steps to ensure that loan holders are protected by gathering information about pending loans and consumer complaints, communicating with consumers, investigating the company's activities, examining circumstances surrounding the closure, and taking enforcement action if deemed necessary.[67]

Developing a systematic way to spot potentially predatory activity as well as locating patterns of fraudulent activity among brokers and lenders is vital to curbing predatory lending and protecting homeowners. For example, **Illinois** has launched a predatory lending database to track the activities of lenders in the Chicago area, enabling quicker identification of potentially questionable lending practices.[68] **Colorado's** new predatory lending legislation attempts to improve efforts to locate predatory lending activity through statistical reports to be produced by the Colorado Division of Insurance.[69]

Some states also are working to ensure that borrowers have the ability to pursue fraudulent lenders in court and seek retribution as victims of predatory lending. Because many predatory loans include mandatory arbitration terms that restrict borrowers' ability to bring suit against lenders if the terms of the loan are found to be unfair or misrepresented, **Minnesota** Governor Tim Pawlenty signed legislation giving borrowers recourse to bring suit against predatory lenders and collect attorney's fees if they win their suit.[70] **Maine**'s homeownership protection law bans mandatory arbitration clauses.[71] **North Carolina** passed new legislation in August 2007 to clarify state Supreme Court decisions that made it difficult for borrowers to sue over illegal lending practices. HB 1374 makes it easier for borrowers to get recourse against predatory lenders.[72]

Additionally, some states have increased criminal penalties for mortgage fraud by allowing state prosecutors to bring criminal charges against those suspected of predatory lending. For example, in June 2007, **Arizona** Governor Janet Napolitano signed HB 2040 to make mortgage fraud a class four felony and a pattern of mortgage fraud a class two felony. **Massachusetts** Governor Deval Patrick has proposed legislation that would define mortgage fraud and create criminal penalties for violations.[73] Currently, authorities may file civil charges against those suspected of mortgage fraud in the state. Under the proposed legislation, the state's attorney general would pursue criminal prosecutions of mortgage fraud. **New Hampshire's** legislation to protect homeowners against mortgage rescue scams makes violation of the law a violation of the Consumer Protection Act, and penalties include fines, jail time, and repayment of equity to the homeowner.[74] Complaints are pursued by the state's banking department.

Educating Homebuyers

Many policymakers cite financial education for potential homeowners as a key component of preventing predatory lending and foreclosure by empowering people to take personal responsibility, avoid predatory loans, and make good financial decisions. Many cities already require first-time homebuyers to undergo prepurchase counseling, and several state and local governments offer homebuyers the opportunity to access no- or low-cost financial education. For example, **Virginia** Governor Tim Kaine signed HB 2513 in February 2007 to allow life skills programs at public colleges and universities to educate students about savings and investments, predatory lending practices and interest rates, consumer fraud, and identity theft and protection.

The **Michigan** Office of Financial and Insurance Services has established a consumer education outreach program to provide consumer and community groups with resources on financial services, scams, and investments.[75] Recent foreclosure legislation from other states such as **Maine**, **Maryland**, **Minnesota**, **New York**, and **Rhode Island** also includes financial education components for troubled borrowers.

In **Montana**, the Montana Board of Housing (MBOH) promotes homebuyer education and individual homeownership planning across the state by providing funding to the 24 partners of the Montana HomeOwnership Network. The homebuyer education program stresses the importance of shopping for the best mortgage terms, while individual homeownership planning helps borrowers improve their credit reports so they can qualify for prime mortgages. Since 1998, more than 12,000 Montanans have completed homebuyer education.

The **Illinois** legislature passed SB 1167 on August 7, 2007, to require homeownership counseling for residents in the Chicago area who wish to obtain a nontraditional mortgage loan. The goal of the legislation is to reduce foreclosures by educating homebuyers. The legislation would require brokers and lenders originating loans in the Chicago area to submit loan information to the state's predatory lending database, after which the Department of Financial and Professional Regulation would determine whether the borrower should receive homeownership counseling, administered by a HUD-certified counseling agency. Originators would fund counseling and would be required to submit documentation that the borrower completed counseling prior to loan origination.

Several other states use Freddie Mac's Don't Borrow Trouble campaign to educate borrowers about the dangers of predatory lending. Don't Borrow Trouble combines consumer outreach with education and counseling to give people the tools they need to avoid being deceived by a predatory lender. **Alaska**, **Connecticut**, **Delaware**, **Kentucky**, **Minnesota**, **Mississippi**, **New Mexico**, **North Carolina**, and **Rhode Island** already have statewide campaigns, as do communities within 20 other states. Because the Don't Borrow Trouble campaign already has several marketing materials and resources for consumers, it is a good tool for states wishing to educate consumers about predatory lending quickly.

Conclusion

States across the country have been feeling the pinch of the growing number of foreclosures. In response, many states are helping troubled borrowers and working to prevent future foreclosures. Facing the possibility that millions of additional households could enter foreclosure, governors are exploring new options to keep families in their homes and protect homeowners.

Current approaches to helping troubled borrowers include:

- Protecting consumers from foreclosure "rescue" scams;
- Connecting borrowers to counseling and resources;
- Encouraging workouts and refinances by working with loan servicers and establishing foreclosure prevention funds; and
- Slowing the foreclosure process.

At the same time, states also are working to prevent future foreclosures by taking steps to reduce predatory lending practices, including:

- Banning common predatory practices;
- Adopting regulatory guidelines for subprime and nontraditional mortgage products;
- Tightening regulation of mortgage brokers and loan originators;
- Increasing criminal penalties for mortgage fraud, enforcing existing lending laws, increasing funding for supervision, and pursuing violators; and
- Educating homebuyers.

States have a long history governing mortgage lending and foreclosure practices through statute and regulation. As foreclosures rise, states are writing new chapters in this history through tough legislation that aims to keep families in their homes, protect potential borrowers from predatory lenders, educate future homeowners, and preserve access to homeownership.

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Attachment 5

MORTGAGE LENDER AND BROKER LICENSURE

EXECUTIVE SUMMARY
October 11, 2007

The area of Mortgage Regulation is a rapidly evolving one in which both state and federal legislators and regulators are working with the various industries involved in this business to address the many problems which have arisen in the past couple of years. The following a some of the most vexatious or prevalent problems in the current mortgage environment:

- Rates on Adjustable Rate Mortgages ("ARMs") are resetting from initial teaser rates to much higher – and more unaffordable rates.
- Rates on ARMs are readjusting as frequently as every six months usually capping the interest rate in double digits for the life of the loan.
- Onerous pre-payment penalties prohibit borrowers from refinancing these high-rate ARMs to mortgages with more affordable fixed rates and terms.
- Use of "no doc" or "low doc" loan applications is so prevalent that many loans are based on unverifiable financial and other information about the borrower;
- Appraisals – arguably the most crucial part of the mortgage transaction – are often performed by individuals who qualifications, knowledge and accountability are suspect.

With respect to the current regulation of mortgage companies, the following can be concluded:

- Effective regulation by both states and the federal government of participants in the mortgage transaction is inconsistent (or non-existent) and has led to too low of a threshold for individuals to join the ranks of mortgage professionals.
- Of the 51 jurisdictions on which we have data, here are interesting data:

Number of Jurisdictions that regulate Mortgage Brokers: 51
Number of Jurisdictions that regulate Mortgage Lenders:
First Mortgages
Second Mortgages
Primary Regulator: Banking Department – 43 (list other agencies)
Number of Jurisdictions that split Regulation between agencies: 4
Number of Jurisdictions that provide exemptions for GSEs: 9

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MORTGAGE LENDER AND BROKER LICENSURE BY JURISDICTION

Jurisdiction:	Does the Jurisdiction require licensure or registration for Mortgage Lenders or Brokers?	Discussion:	Additional Notes:
Alabama	**Lenders: Yes, if the entity has sufficient contacts in Alabama.** **Brokers: Yes**	**Lenders** (a) No creditor having a place of business in Alabama, or having a resident employee in Alabama whose employment includes making consumer loans or taking assignments of consumer credit contracts shall engage in the business of making consumer loans or taking assignments of consumer credit contracts without first having obtained a license for each location in Alabama from the administrator; provided, however, that a creditor having no place of business in Alabama but having a resident employee in Alabama whose employment includes making consumer loans or taking assignments of consumer credit contracts shall obtain a license for the location where the creditor maintains its records regarding Alabama loans or Alabama consumer credit contracts; and provided further, that, banks chartered by this state or any other state, banks chartered by the United States, trust companies, savings or building and loan associations, savings banks and other thrift institutions, credit unions, life insurance companies, and federally constituted agencies shall be exempt from licensing. A seller, with respect to consumer credit sale transactions and the financing of charges permitted by this chapter, is not required to be licensed under this chapter. Ala.Code 1975 § 5-19-22 () **Brokers** (a) On and after January 1, 2002, no person shall transact business in this state directly or indirectly as a mortgage broker unless he or she is licensed as a mortgage broker by the	**Regulator:** Alabama State Banking Department Link:www.bank.state.al.us

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		department, or is a person exempted from the licensing requirements pursuant to Section 5-25-3.Ala.Code 1975 § 5-25-4	
Alaska	**Lenders: Yes** **Brokers: Yes** **(effective 1-1-08)**	**Lenders & Brokers** **License required.** (a) Except as provided under AS 06.60.015, a person, including a person doing business from outside this state, may not operate as a mortgage lender or mortgage broker in this state unless the person is licensed under this chapter. **A.S. § 06.60**	**Regulator:** Division of Banking and Securities Link: www.dced.state.ak.us/bsc/
Arizona	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** **A.** A person shall not act as a mortgage banker if he is not licensed under this article. A.R.S. § 6-943 () **A.** A person shall not act as a mortgage broker if he is not licensed under this article. A.R.S. § 6-903	**Regulator:** Department of Financial Institutions Link: http://www.azbanking.com
Arkansas	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** (a)(1) It is unlawful for any person located in Arkansas, other than an exempt person, to act or attempt to act, directly or indirectly, as a mortgage broker, mortgage banker, loan officer, or mortgage servicer without first obtaining a license from the Securities Commissioner under this subchapter.	**Regulator:** Arkansas Securities Department Link: www.securities.arkansas.gov
California	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** No person shall engage in the business of a finance lender or broker without obtaining a license from the commissioner. West's Ann.Cal.Fin.Code § 22100 (California Finance Lenders Law) (a) No person shall engage in the business of making residential mortgage loans or servicing residential mortgage loans, in this state, without first obtaining a license from the commissioner in accordance with the requirements of Chapter 2 (commencing with Section 50120) or Chapter 3 (commencing with Section 50130), and any rules promulgated by the commissioner under this law, unless a person or transaction is excepted from a definition or exempt from licensure by a provision of this law or a rule of the commissioner. West's Ann.Cal.Fin.Code § 50002 () (California Residential Mortgage Act)It is unlawful for any	**Regulator:** Department of Corporations for mortgage lenders and brokers under Cal. Finance Lenders Law and for mortgage lenders under the Cal. Residential Mortgage Act **Regulator:** Department of Real Estate for real estate brokers (are permitted to broker mortgage loans under Real Estate Law) **California** is a little different from other states in the way it handles mortgage regulation and has 3 statutory schemes: (1) Licensed real estate brokers and salesmen are also authorized to serve as brokers for mortgages. (2) California also has a Residential Mortgage Act which allows licensees to make residential mortgages. (3) The California Finance Lenders Law licenses lenders engaged in the business of making consumer or commercial loans. Links: http://www.corp.ca.gov: (Cal. Finance Lenders Law) http://www.dre.cahwnet.gov/; (Real Estate Law) http://www.corp.ca.gov (Cal Residential Mortgage Act)

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		person to engage in the business, act in the capacity of, advertise or assume to act as a real estate broker or a real estate salesman within this state without first obtaining a real estate license from the department. West's Ann.Cal.Bus. & Prof.Code § 10130 (Real Estate Law)	
Colorado	**Yes**. A Supervised Lender's License is required in connection with certain loan types **Yes** as to brokers effective 1-1-07	**Lenders** (1) Unless a person is a supervised financial organization or has first obtained a license from the administrator authorizing him or her to make supervised loans, he or she shall not engage in the business of: (a) Making supervised loans or undertaking direct collection of payments from or enforcement of rights against consumers arising from supervised loans he or she has previously made; or (b) Taking assignments of and undertaking direct collection of payments from or enforcement of rights against consumers arising from supervised loans. C.R.S.A. § 5-2-301 () **Brokers** Colorado has enacted a mortgage broker registration statute. The licensing requirement went into effect on January 1, 2007.	**Regulator:** Division of Real Estate of the Department of Regulatory Agencies for brokers **Regulator:** Attorney General for second mortgage lenders Links: http://www.ago.state.co.us/UCCC/UCCCmain.cfm (Uniform Consumer Credit Code) http://www.dora.state.co.us/real-estate (Mortgage Broker Registration Act)
Connecticut	**Lenders: Yes** **Brokers: Yes**	**Lenders** (a) No person shall engage in the business of making first mortgage loans or act as a first mortgage broker in this state unless such person has first obtained the required license in accordance with the provisions of sections 36a-485 to 36a-498a, inclusive. C.G.S.A. § 36a-486 (a) No person shall engage in the business of making secondary mortgage loans or act as a secondary mortgage broker unless such person has first obtained the required license under sections 36a-510 to 36a-524, inclusive. C.G.S.A. § 36a-511	**Regulator:** Department of Banking for first and second mortgage lenders and mortgage brokers Links: http://www.state.ct.us/dob (Nondepository First Mortgage Lenders and Brokers Act) http://www.state.ct.us/dob (Secondary Mortgage Loan Act)

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

		Brokers (a) No person shall engage in the business of making first mortgage loans or act as a first mortgage broker in this state unless such person has first obtained the required license in accordance with the provisions of sections 36a-485 to 36a-498a, inclusive. C.G.S.A. § 36a-486 (a) No person shall engage in the business of making secondary mortgage loans or act as a secondary mortgage broker unless such person has first obtained the required license under sections 36a-510 to 36a-524, inclusive. C.G.S.A. § 36a-511	
Delaware	**Lenders: Yes** **Brokers: Yes**	**Lenders** (a) Every person desiring to transact the business of lending money in this State shall be required to obtain a license under this chapter; provided, however, that a person that makes not more than 5 loans within any 12-month period shall be deemed not to be transacting the business of lending money. Except as otherwise provided by law, loans made by any such unlicensed lender shall fall under Chapter 23 of Title 6. This chapter shall not apply: (1) To any banking organization, federal credit union or insurance company; or (2) To any other person, if and to the extent that such person is lending money in accordance with and as authorized by any other applicable law of this State or the United States, including but not limited to the registration requirements in Chapter 17 of this title. DE ST TI 5 § 2202 () **Brokers** Subject to the provisions of subsection (b) of this section, every person desiring to transact the business of a mortgage loan broker shall be required to obtain a license under this chapter; provided however, that a person who acts as a mortgage loan broker with respect to 5 or fewer mortgage loans within any 12-month period shall be deemed not to be transacting the business of a mortgage loan broker. DE ST TI 5 § 2102	**Regulator:** State Bank Commissioner Links: http://www.state.de.us/bank/default.shtml Licensed Lenders Act http://www.state.de.us/bank/default.shtml Mortgage Loan Broker Act

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

District of Columbia	**Lenders: Yes** **Brokers: Yes**	No person shall engage in business as a mortgage lender or mortgage broker, or both, or hold himself out to the public to be a mortgage lender or mortgage broker for 60 days after September 9, 1996, unless such person has first obtained a license under this chapter. DC ST § 26-1103	**Regulator:** Banking Bureau of the Department of Insurance, Securities and Banking for both mortgage lenders and brokers Links: http://www.dbfi.washingtondc.gov
Florida	**Lenders: Yes** **Brokers: Yes**	**Lenders** It is unlawful for any person: (1) To act as a mortgage lender in this state without a current, active license issued by the office pursuant to ss. 494.006-494.0077. (2) To act as a correspondent mortgage lender in this state without a current, active license issued by the office pursuant to ss. 494.006-494.0077. West's F.S.A. § 494.0025 () **Brokers** Each natural person who acts as a mortgage broker for a mortgage brokerage business must be licensed pursuant to this section. To act as a mortgage broker, an individual must be an associate of a mortgage brokerage business. A mortgage broker is prohibited from being an associate of more than one mortgage brokerage business. West's F.S.A. § 494.0033	**Regulator:** Office of Financial Regulation, Division of Finance for both mortgage lenders and brokers Links: http://www.flofr.com Very large volume: 82,000 individuals licensed as individual mortgage brokers (all must be affiliated with a company) 10,000 mortgage broker companies are licensed 12,000 mortgage lenders licensed
Georgia	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** On and after July 1, 1993, it is prohibited for any person to transact business in this state directly or indirectly as a mortgage broker or a mortgage lender unless such person: (1) Is licensed or registered as such by the department; (2) Is a person exempted from the licensing or registration requirements pursuant to Code Section 7-1-1001; or (3) In the case of an employee of a mortgage broker or mortgage lender, such person has qualified to be relieved of the necessity for a license under the employee exemption in paragraph (11) of Code Section 7-1-1001. Ga. Code Ann., § 7-1-1002	**Regulator:** Department of Banking and Finance for both mortgage lenders and brokers Links: www.ganet.org/dbf/
Hawaii	**No license is required in connection with Foreign Lender Status/Yes**	**Consumer Lenders & Brokers** Except as expressly permitted by federal law or this chapter, no person shall engage in any activity for which a license to operate as a financial services loan company is required by	**Regulator:** Department of Commerce and Consumer Affairs Professional and Vocational Licensing Division of the Department of Commerce and Consumer Affairs Links:

		this chapter, including without limitation, making loans and extensions of credit where the interest charged, contracted for, or received is in excess of rates permitted by law other than this article, the use of the term "financial services loan company", or the exercise of such other powers or privileges restricted to financial services loan companies under applicable law unless it is a corporation incorporated in this State and has such a license; provided that a nondepository financial services loan company shall not be required to be incorporated in this State. HI ST § 412-9 (a) No person shall act as a mortgage broker or mortgage solicitor without a license therefor as provided in this chapter, and no person not licensed under this chapter shall charge or receive any commission, fee, or bonus in connection with arranging for, negotiating, or selling a mortgage loan. HI ST § 454-3	http://www.hawaii.gov/dcca/areas/dfi http://www.hawaii.gov/dcca/areas/pvl/programs/mortgage/ (Mortgage Brokers) Task Force is considering revising mortgage broker regulations.
Idaho	**Lenders: Yes** **Brokers: Yes**	**Lenders and Brokers** (1) Any person, except a person exempt under section 26-3103, Idaho Code, who engages in mortgage brokering or mortgage lending activities without first obtaining a mortgage broker or mortgage lender license in accordance with this chapter, shall be guilty of a felony. ID ST § 26-3104	**Regulator:** Department of Finance for mortgage lenders and brokers Links: http://finance.idaho.gov
Illinois	**Lenders: Yes** **Brokers: Yes**	**Lenders and Brokers** (a) No person, partnership, association, corporation or other entity shall engage in the business of brokering, funding, originating, servicing or purchasing of residential mortgage loans without first obtaining a license from the Commissioner in accordance with the licensing procedure provided in this Article I and such regulations as may be promulgated by the Commissioner. 205 ILCS 635/1-3	**Regulator:** Department of Financial and Professional Regulation for mortgage lenders and brokers Links: http://www.idfpr.com
Indiana	**Yes, for 2nd Mortgage Consumer Loans/ Yes for Loan Brokers**	**Consumer Lenders (2nd mortgage)** Authority to Make Consumer Loans--Unless a person is a supervised financial organization or has first obtained a license from the department, the person shall not regularly engage in this state in the business of: (a) making consumer loans; or	**Regulators:** Department of Financial Institutions for 2nd mortgage consumer lenders under Uniform Consumer Credit Code; Securities Division of Indiana Secretary of State for loan brokers (No license required for first mortgage lenders) Links: http://www.in.gov/sos/securities/ for loan brokers www.in.gov/dfi for UCCC 2nd mortgage lenders

		(b) taking assignments of and undertaking direct collection of payments from or enforcement of rights against debtors arising from consumer loans. However, an assignee may collect and enforce for three (3) months without a license if the assignee promptly applies for a license and the assignee's application has not been denied. IC 24-4.5-3-502 () **Brokers** Any person desiring to engage or continue in the loan brokerage business shall apply to the commissioner for a license under this chapter. IC 23-2-5-4	
Iowa	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** A person shall not act as a mortgage banker or mortgage broker in this state or use the title "mortgage banker" or "mortgage broker" without first obtaining a license from the administrator. I.C.A. § 535B.4	**Regulator:** Iowa Division of Banking for mortgage lenders and brokers Links: www.idob.state.ia.us
Kansas	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** (a) Mortgage business shall only be conducted in this state at or from a mortgage company licensed by the commissioner as required by this act. A licensee shall be responsible for all mortgage business conducted on their behalf by loan originators or other employees. KS ST § 9-2203 (g) "Mortgage business" means engaging in, or holding out to the public as willing to engage in, for compensation or gain, or in the expectation of compensation or gain, directly or indirectly, the business of making, originating, servicing, soliciting, placing, negotiating, acquiring, selling, or arranging for others, or offering to solicit, place, negotiate, acquire, sell or arrange for others, mortgage loans in the primary market. KS ST § 9-2201	Regulator: Links: Uniform Consumer Credit Code www.osbckansas.org Kansas Mortgage Business Act www.osbckansas.org Loan Brokers Act www.securities.state.ks.us
Kentucky	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** 1) (a) It is unlawful for any person to transact business in this state, either directly or indirectly, as a mortgage loan company or mortgage loan broker if he is not licensed under this chapter and registered in	**Regulator:** Office of Financial Institutions for mortgage lenders and brokers Links: http://www.kfi.ky.gov

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

		accordance with KRS 294.255, unless that person is exempt under KRS 294.020 and, if required by KRS 294.020(3) to file a claim of exemption, has filed a claim of exemption and the filed claim of exemption has been allowed by the executive director. KRS § 294.030	
Louisiana	**Lenders: Yes** **Brokers: Yes**	**Lenders and Brokers** A. Beginning January 1, 2000, no person shall engage in any residential mortgage lending activity in this state unless such person has first obtained a license in accordance with the provisions of this Chapter. LSA-R.S. 6:1086 (Louisiana Residential Mortgage Lending Act) (11) "Residential mortgage lending activity" means an activity, including electronic activity, engaged in for compensation or with the expectation of compensation in connection with a residential loan transaction, including the origination or funding of a residential mortgage loan and the negotiation and placement, or offering to negotiate, place, or find a residential mortgage loan for another person. LSA-R.S. 6:1083	**Regulator:** Office of Financial Institutions Louisiana Residential Mortgage Lending Act Links: http://www.ofi.state.la.us The Louisiana Residential Mortgage Lending Act is the primary law governing mortgage lenders and brokers. however it permits the parties to a consumer loan that is secured by a residential mortgage to make the loan subject to the Louisiana Consumer Credit Law licenses parties to be broker
Maine	**Yes, for Supervised Loans/** **Yes for Brokers*** It's called registration, but it is required prior to doing business. Therefore, "Yes."	**Lenders** Unless a person is a supervised financial organization or has first obtained a license pursuant to this Act from the administrator authorizing him to make supervised loans, he shall not engage in the business of: 1. Making supervised loans; or 2. Taking assignments of and undertaking direct collection of payments from or enforcement of rights from an office in this State against debtors arising from supervised loans. 9-A M.R.S.A. § 2-301 () **Brokers** § 10-201. Registration and annual re-registration A person desiring to engage or continue in business in this State as a credit services organization shall apply to the administrator for	**Regulators:** Bureau of Consumer Credit Protection for supervised lenders and loan brokers Links: http://janus.state.me.us/legis/statutes/9-A/title9-Asec9-201.html Consumer Credit Code- Supervised Lenders http://janus.state.me.us/legis/statutes/9-A/title9-Asec10-201.html Consumer Credit Code-Brokers

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

		registration under this article on or before January 31st of each year. The application must be in a form prescribed by the administrator. The administrator may refuse the application if it contains erroneous or incomplete information.	
Maryland	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** A person may not act as a mortgage lender unless the person is: (1) A licensee; (2) A person exempted from licensing under this subtitle; or (3) A person registered under § 11-522 of this subtitle. MD Code, Financial Institutions, § 11-504 (j) (1) "Mortgage lender" means any person who: (i) Is a mortgage broker; (ii) Makes a mortgage loan to any person; or (iii) 1. Engages in whole or in part in the business of servicing mortgage loans for others; or 2. Collects or otherwise receives payments on mortgage loans directly from borrowers for distribution to any other person. (2) "Mortgage lender" does not include: (i) A financial institution that accepts deposits and is regulated under Title 3, Title 4, Title 5, or Title 6 of this article; (ii) The Federal Home Loan Mortgage Corporation; (iii) The Federal National Mortgage Association; (iv) The Government National Mortgage Association; or (v) Any person engaged exclusively in the acquisition of all or any portion of a mortgage loan under any federal, State, or local governmental program of mortgage loan purchases. MD Code, Financial Institutions, § 11-501	**Regulator:** Commissioner of Financial Regulation Links: http://www.dllr.state.md.us/finance/ Mortgage Lender Law http://www.dllr.state.md.us/finance/ Mortgage Originator Law
Massachusetts	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** No person shall act as a mortgage broker or mortgage lender with respect to residential property unless first obtaining a license from the commissioner; provided, however, that any person who is employed by or associated with a licensed mortgage broker or mortgage lender in the capacity of a mortgage broker or mortgage lender under the direction of said licensed mortgage broker or mortgage lender	**Regulator:** Division of Banks of Office of Consumer Affairs Links: http://www.mass.gov/dob Mortgage Lender and Broker Laws

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

		shall not be required to obtain such license. M.G.L.A. 255E § 2	
Michigan	**Lenders: Yes** **Brokers: Yes**	Lenders/brokers first mortgages Sec. 2. (1) A person shall not act as a mortgage broker, mortgage lender, or mortgage servicer without first obtaining a license or registering under this act, unless 1 or more of the following apply: (a) The person is solely performing services as an employee of only 1 mortgage broker, mortgage lender, or mortgage servicer. (b) The person is exempted from the act under section 25. (c) The person is licensed as a class I licensee under the consumer financial services act, 1988 PA 161, MCL 487.2051 to 487.2072. M.C.L.A. 445.1652 Sec. 2. (1) Except for a person licensed under the consumer financial services act, 1988 PA 161, MCL 487.2051 to 487.2072, a depository financial institution, or an exclusive broker, a person shall not act as a broker, lender, or servicer without first obtaining a license or registration as provided by this act.	**Regulator:** Office of Financial & Insurance Services Links: http://www.michigan.gov/cis/0%2C1607%2C7-154-10555---%2C00.html Mortgage Brokers, Lenders, and Servicers Licensing Act http://www.michigan.gov/cis/0%2C1607%2C7-154-10555---%2C00.html Secondary Mortgage Loan Act MI has 2 laws: first covers brokers, lenders and servicers of first mtg: (Mortgage Brokers, Lenders, and Servicers Licensing Act) second covers brokers, lenders and servicers of junior liens: (The Secondary Mortgage Loan Act) Do not license individual loan originators Risk-based exams only; not enough staff to do more exams Would like to define "mortgage fraud" for both criminal and civil matters (like Ga)
Minnesota	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** (a) Beginning August 1, 1999, no person shall act as a residential mortgage originator, or make residential mortgage loans without first obtaining a license from the commissioner according to the licensing procedures provided in this chapter. M.S.A. § 58.04 "Residential mortgage originator" means a person who, directly or indirectly, for compensation or gain or in expectation of compensation or gain, solicits or offers to solicit, or accepts or offers to accept an application for a residential mortgage loan through any medium or mode of communication from a borrower, or makes a residential mortgage loan. "Residential mortgage originator" includes a lender as defined in subdivision 11 and a broker as defined in subdivision 13. M.S.A. § 58.02	**Regulator:** Department of Commerce Links: http://www.commerce.state.mn.us Minnesota Residential Mortgage Originator and Servicer Licensing Act
Mississippi	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** (1) On and after July 1, 2000, no person or	**Regulator:** Department of Banking & Consumer Affairs

		natural person shall transact business in this state, directly or indirectly, as a mortgage company unless he or she is licensed or registered as a mortgage company by the department or is a person exempted from the licensing requirements under Section 81-18-5. Miss. Code Ann. § 81-18-7 () (m) "Mortgage company" means any person or entity who directly, indirectly or by electronic activity, solicits, places or negotiates mortgage loans for others, or offers to solicit, place or negotiate mortgage loans for others. Unless indicated otherwise, the use of the word "company" in this chapter means "mortgage company" as defined in this paragraph (m). Miss. Code Ann. § 81-18-3	Links: www.dbcf.state.ms.us Mississippi Mortgage Consumer Protection Law
Missouri	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** No person shall engage in the business of brokering, funding, originating, servicing or purchasing of residential mortgage loans without first obtaining a license from the director, pursuant to sections 443.800 to 443.893 and the regulations promulgated thereunder. V.A.M.S. 443.805	**Regulator:** Division of Finance Links: http://www.missouri-finance.org/ Residential Mortgage Broker License Act
Montana	**Lenders: Yes (as of January 1, 2008)** **Brokers: Yes**	(2) A mortgage banker who provides services for a fee as an intermediary between a borrower and a lender in obtaining financing for a borrower that is to be secured by a residential dwelling for between one and four families is acting as a mortgage broker and must be licensed as a mortgage broker. MT ST 32-9-102 ()	**Regulator:** Division of Finance and Banking Institutions Links: http://www.discoveringmontana.com/doa/banking Consumer Loan Act http://www.discoveringmontana.com/doa/banking Mortgage Broker and Loan Originator Licensing Act
Nebraska	**Lenders: Yes** **Brokers: Yes**	(1) No person shall act as a mortgage banker or use the title mortgage banker in this state unless he, she, or it is licensed or has registered with the department as provided in the Mortgage Bankers Registration and Licensing Act or is licensed under the Nebraska Installment Loan Act. NE ST § 45-705 (6) Mortgage banker means any person not exempt under section 45-703 who, for compensation or gain or in the expectation of compensation or gain, directly or indirectly makes, originates, services, negotiates, acquires, sells, arranges for, or offers to make, originate, service, negotiate, acquire, sell, or arrange for ten or more mortgage loans in a calendar year NE ST § 45-702	**Regulator:** Department of Banking & Finance Links: http://www.ndbf.org Mortgage Bankers Registration and Licensing Act http://www.ndbf.org Installment Loan Act

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

Nevada	**Lenders: Yes** **Brokers: Yes**	**Lenders:** It is unlawful for any person to offer or provide any of the services of a mortgage banker or otherwise to engage in, carry on or hold himself out as engaging in or carrying on the business of a mortgage banker without first obtaining a license as a mortgage banker pursuant to this chapter, unless the person: 1. Is exempt from the provisions of this chapter; and 2. Complies with the requirements for that exemption. N.R.S. 645E.900 () **Brokers:** 1. A license as a mortgage broker entitles a licensee to engage only in the activities authorized by this chapter. N.R.S. 645B.035	**Regulator:** Mortgage Lending Division Links: http://www.mld.nv.gov/ Mortgage Banker Act and Mortgage Broker Act
New Hampshire	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** 397-A:3 License Required. Any person not exempt under RSA 397-A:4 that, in its own name or on behalf of other persons, engages in the business of making or brokering mortgage loans secured by real property located in this state shall be required to obtain a license from the department. Persons licensed as mortgage bankers may engage in the mortgage broker business without obtaining a separate license. NH LEGIS 255 (2005)	**Regulator:** Banking Department Links: http://webster.state.nh.us/banking/index.html Nondepository Mortgage Lenders and Brokers Act
New Jersey	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers** a. No person shall act as a mortgage banker or mortgage broker, engage in the secondary mortgage loan business or engage in the consumer loan business without first obtaining a license under this act, except that a person licensed as a mortgage banker may act as a mortgage broker or mortgage solicitor, and a person licensed as a mortgage broker may act as a mortgage solicitor. N.J.S.A. 17:11C-3	**Regulator:** Office of Consumer Finance, Department of Banking and Insurance Links: http://www.state.nj.us/dobi/index.html Licensed Lenders Act
New Mexico	Lenders: Yes **Brokers: Yes** **It's called registration, but it is required**	**Lenders & Brokers:** It is unlawful for any person to transact business in the state of New Mexico, either directly or indirectly, as a mortgage loan company or loan broker without first filing an application with the director and obtaining a	**Regulator:** Financial Institutions Division Links: www.RLD.state.nm.us/FID Mortgage Loan Company and Loan Broker Act

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

	prior to doing business. Therefore, "Yes."	registration certificate under the Mortgage Loan Company and Loan Broker Act. N. M. S. A. 1978, § 58-21-3	
New York	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** (a) No person, partnership, association, corporation or other entity shall engage in the business of making five or more mortgage loans in any one calendar year without first obtaining a license from the superintendent in accordance with the licensing procedure provided in this article and such regulations as may be promulgated by the banking board or prescribed by the superintendent. The licensing provisions of this subdivision shall not apply to any exempt organization nor to any entity or entities which shall be exempted in accordance with regulations promulgated by the banking board hereunder. McKinney's Banking Law § 590 ()	**Regulator:** Banking Department Links: www.banking.state.ny.us
North Carolina	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** (a) Other than an exempt person, it is unlawful for any person in this State to act as a mortgage broker or mortgage banker, or directly or indirectly to engage in the business of a mortgage broker or a mortgage banker, without first obtaining a license from the Commissioner under the provisions of this Article. NC LEGIS 2005-316 (2005)	**Regulator:** Commissioner of Banks Links: http://www.nccob.com
North Dakota	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** Except as otherwise herein provided, a person other than a money broker licensed and authorized under this chapter may not provide loans or leases as a form of financing, or advertise or solicit either in print, by letter, in person, or otherwise in North Dakota, the right to find lenders or provide loans or leases for persons or businesses desirous of obtaining funds for any purposes. ND ST 13-04.1-02 ()	**Regulator:** Department of Financial Institutions Links: http://www.state.nd.us/dfi/ Money Brokers Act
Ohio	**Lenders: Yes for table funding brokers in connection with first lien loans, and Yes in connection with subordinate lien loan transactions./**	**Lenders & Brokers:** (A)(1) No person, on the person's own behalf or on behalf of any other person, shall act as a mortgage broker without first having obtained a certificate of registration from the superintendent of financial institutions for every office to be maintained by the person for the transaction of business as a mortgage broker in this state. A registrant shall maintain an office location in this state for the transaction of	**Regulator:** Division of Financial Institutions Links: Second Mortgage Security Loans Act http://www.com.state.oh.us/dfi/default.htm Mortgage Broker Act http://www.com.state.oh.us/dfi/default.htm

Judith G. Ripley, Director
Indiana Department of Financial Institutions
30 South Meridian Street, Suite 300
Indianapolis, IN 46204

	Brokers: Yes, It's called registration, but it is required prior to doing business. Therefore, "Yes."	business as a mortgage broker in this state. R.C. § 1322.02 () (G) "Mortgage broker" means any of the following: (1) A person that holds that person out as being able to assist a buyer in obtaining a mortgage and charges or receives from either the buyer or lender money or other valuable consideration readily convertible into money for providing this assistance; (2) A person that solicits financial and mortgage information from the public, provides that information to a mortgage broker, and charges or receives from the mortgage broker money or other valuable consideration readily convertible into money for providing the information; (3) A person engaged in table-funding or warehouse-lending mortgage loans that are first lien mortgage loans. R.C. § 1322.01 () (A)(1) No person, on that person's own behalf or on behalf of any other person, shall do either of the following without having first obtained a certificate of registration from the division of financial institutions: (a) Advertise, solicit, or hold out that the person is engaged in the business of making loans secured by a mortgage on a borrower's real estate which is other than a first lien on the real estate; (b) Engage in the business of lending or collecting the person's own or another person's money, credit, or choses in action for such loans. R.C. § 1321.52 ()	
Oklahoma	**Lenders: Yes, (generally as well as in connection with making supervised loans)** **Brokers: Yes**	**Lenders & Brokers:** Unless exempt from licensure under the Mortgage Broker Licensure Act, a person may not engage in the business of a mortgage broker without first obtaining and maintaining a license under the Mortgage Broker Licensure Act. However, a person who independently contracts with a licensed mortgage broker to perform mortgage broker services need not be licensed if the licensed mortgage broker and	**Regulator:** Department of Consumer Credit Links: Mortgage Broker Licensure Act http://www.okdocc.state.ok.us Uniform Consumer Credit Code http://www.okdocc.state.ok.us

		the independent contractor have on file with the Administrator of Consumer Credit a binding written agreement under which the licensed mortgage broker assumes responsibility for the independent contractor's violations of any provision of this act or rules promulgated pursuant to the provisions of the Mortgage Broker Licensure Act. 59 Okl.St.Ann. § 2084 () 11. "Mortgage broker" means any person who is not exempt under Section 2083 of this title and who for compensation or in the expectation of compensation either directly or indirectly makes, negotiates or offers to make or negotiate a residential mortgage loan; 59 Okl.St.Ann. § 2082 () (1) Unless a person is a supervised financial organization or has first obtained a license from the Administrator authorizing the person to make supervised loans, a person shall not engage in the business of: (a) making supervised loans; or (b) taking assignments and undertaking direct collection of payments from or enforcement of rights against debtors arising from supervised loans. 14A Okl.St.Ann. § 3-502 ()	
Oregon	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** (1) It is unlawful for any person to engage in residential mortgage transactions in this state as a mortgage banker or mortgage broker unless the person is licensed under ORS 59.840 to 59.980. A person who is a mortgage banker or mortgage broker under ORS 59.840, but who does not engage in residential mortgage transactions in this state, is not required to obtain a license under ORS 59.840 to 59.980. O.R.S. § 59.845	**Regulator:** Division of Finance and Corporate Securities of Department of Business and Consumer Services Links: http://www.Oregondfcs.org/ Oregon Mortgage Lender Law
Pennsylvania	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** **(a) License required.**--On and after the effective date of this act, no person shall act as a mortgage banker, loan correspondent, mortgage broker or limited mortgage broker in this Commonwealth without a license as provided for in this chapter, provided, however, that any person licensed as a mortgage banker may also act as a loan correspondent or	**Regulator:** Department of Banking Links: http://www.banking.state.pa.us Mortgage Bankers and Brokers and Consumer Equity Protection Act http://www.banking.state.pa.us Secondary Mortgage Loan Act

		mortgage broker and any person licensed as a loan correspondent may also act as a mortgage broker without a separate license. A person licensed as a mortgage broker may only perform the services of a mortgage broker. **Secondary Loan Brokers:** 63 P.S. § 456.302 (2) No person shall engage in the business of being a secondary mortgage loan broker until after first obtaining a license from the secretary in accordance with the provisions of this act. 7 P.S. § 6603	
Rhode Island	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** No person shall engage within this state in the business of: (1) making or funding loans or acting as a lender or small loan lender; (2) brokering loans or acting as a loan broker; (3) selling checks for a fee or other consideration; (4) cashing checks for a fee or other consideration which includes any premium charged for the sale of goods in excess of the cash price of the goods; (5) providing electronic money transfers for a fee or other consideration; or (6) providing debt management plan(s) without first obtaining a license from the director or the director's designee. RI ST § 19-14-2	**Regulator:** Department of Business Regulation Links: www.dbr.state.ri.us General Laws Licensed Activities Act
South Carolina	**Lenders: Yes, in connection with Supervised Loans** **Brokers: Yes**	**Lenders:** Unless a person is a supervised financial organization or has first obtained a license from the State Board of Financial Institutions authorizing him to make supervised loans, he shall not engage in the business of (1) making supervised loans, or (2) taking assignments of and undertaking direct collection of payments from or enforcement of rights against debtors arising from supervised loans. Code 1976 § 37-3-502 () **Brokers:** Section 40-58-30. (A) A mortgage broker, as defined in Section 40-58-20(3), or an originator, as defined in Section 40-58-20(14), may not engage in the business of processing, placing, or negotiating a mortgage or offering to process, place, or negotiate a mortgage in this State without first being licensed with the administrator. SC LEGIS 7 (2005)	**Regulator:** Department of Consumer Affairs for Brokers **Regulator:** State Board of Financial Institutions (for second mortgages) Links: http://www.scconsumer.gov Consumer Protection Code http://www.scconsumer.gov Licensing Requirements Act of Certain Brokers of Mortgages on Residential Real Property

Judith G. Ripley, Director
Indiana Department of Financial Institutions
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Indianapolis, IN 46204

South Dakota	**Lenders: Yes** **Brokers: Yes**	**Lenders & Brokers:** Any person who engages in the business of a mortgage banker or mortgage broker shall obtain an original license to engage in such business under the terms and conditions of this chapter, shall apply therefor under oath, on forms prescribed by the division, and shall pay an original, nonrefundable license fee as set by rules of the commission promulgated pursuant to chapter 1-26. SDCL. § 54-14-2	**Regulator:** Division of Banking Links: http://www.state.sd.us/banking Mortgage Lender Business Statute
Tennessee	**Lenders: Yes** **Brokers: Yes**	**Lenders and Brokers:** (a) No person shall act as a mortgage lender, mortgage loan broker, mortgage loan servicer, or mortgage loan originator in this state without first complying with the applicable licensing or registration requirements under this chapter; provided, however, that no contractor or home improvement contractor or other person who supplies materials and renders services in the improvement of real property shall engage in the business of making mortgage loans or of being a mortgage loan servicer or mortgage loan broker in this state. T. C. A. § 45-13-103	**Regulator:** Department of Financial Institutions Links: http://www.state.tn.us/financialinst Residential Lending, Brokerage and Servicing Act of 1988
Texas	**Lenders: Yes, under the Mortgage Banker Registration Act and/or Chapter 342 of the Texas Finance Code, as applicable** **Brokers: Yes**	**Lenders:** (a) A person must register under this chapter before the person may conduct the business of a mortgage banker in this state, unless the person is exempt under this section or Section 157. 004. V.T.C.A., Finance Code § 157.003 () Brokers: (a) A person may not act in the capacity of, engage in the business of, or advertise or hold that person out as engaging in or conducting the business of a mortgage broker in this state unless the person holds an active mortgage broker license or is exempt under Section 156.202. V.T.C.A., Finance Code § 156.201	**Regulator:** Department of Savings and Mortgage Lending Office of Consumer Credit Commissioner Links: http://www.sml.state.tx.us Mortgage Banker Registration Act http://www.sml.state.tx.us Mortgage Broker License Act www.occc.state.tx.us/ Secondary Mortgage Loan Act

		Consumer Loans: (a) A person must hold a license issued under this chapter to: (1) engage in the business of making, transacting, or negotiating loans subject to this chapter; or (2) contract for, charge, or receive, directly or indirectly, in connection with a loan subject to this chapter, a charge, including interest, compensation, consideration, or another expense, authorized under this chapter that in the aggregate exceeds the charges authorized under other law. V.T.C.A., Finance Code § 342.051 ()	
Utah	**Lenders: Yes** **Brokers: Yes**	(1) Unless exempt from this chapter under Section 61-2c-105, an individual or entity may not transact the business of residential mortgage loans, as defined in Section 61-2c-102, without obtaining a license under this chapter. U.C.A. 1953 § 61-2c-201 (e)(i) "Business of residential mortgage loans" means for compensation to: (A) make or originate a residential mortgage loan; (B) directly or indirectly solicit, place, or negotiate a residential mortgage loan for another; or (C) render services related to the origination of a residential mortgage loan including: (I) taking applications; and (II) communicating with the borrower and lender. U.C.A. 1953 § 61-2c-102 (1) Except as provided in Subsection (2), no person may engage in the business of making mortgage loans nor may any person engage in the business of being a mortgage loan broker or servicer, without first filing written notification with the department and paying the fees required by this chapter. U.C.A. 1953 § 70D-1-10	**Regulator:** Division of Real Estate of Department of Commerce **Regulator:** Department of Financial Institutions for second mortgages Links: http://www.commerce.utah.gov/dre Utah Residential Mortgage Practices Act http://www.dfi.utah.gov Utah Consumer Credit Code
Vermont	**Lenders: Yes** **Brokers: Yes**	(a) No person shall without first obtaining a license under this chapter from the commissioner: (1) engage in the business of making loans of money, credit, goods or things in action and charge, contract for or receive on any such loan interest, a finance charge, discount or	**Regulator**: Department of Banking, Insurance, Securities and Health Care Administration Links: www.bishca.state.vt.us Licensed Lenders Act

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		consideration therefor; (2) act as a mortgage broker; or (3) act as a sales finance company. VT ST T. 8 § 2201	
Virginia	**Lenders: Yes** **Brokers: Yes**	No person shall engage in business as a mortgage lender or a mortgage broker, or hold himself out to the general public to be a mortgage lender or a mortgage broker unless such person has first obtained a license under this chapter. However, subject to such conditions as the Commission may prescribe, an individual who is a bona fide employee or exclusive agent of a person licensed under this chapter may negotiate, place or find mortgage loans without being licensed as a mortgage broker. Va. Code Ann. § 6.1-410	**Regulator**: Bureau of Financial Institutions Mortgage Lender and Broker Act www.state.va.us/scc/division/banking
Washington	**Yes, under the Mortgage Broker Practices Act or the Consumer Loan Act, as applicable.**	(1) A person may not engage in the business of a mortgage broker, except as an employee of a person licensed or exempt from licensing, without first obtaining and maintaining a license under this chapter. However, a person who independently contracts with a licensed mortgage broker need not be licensed if the licensed mortgage broker and the independent contractor have on file with the director a binding written agreement under which the licensed mortgage broker assumes responsibility for the independent contractor's violations of any provision of this chapter or rules adopted under this chapter; and if the licensed mortgage broker's bond or other security required under this chapter runs to the benefit of the state and any person who suffers loss by reason of the independent contractor's violation of any provision of this chapter or rules adopted under this chapter. West's RCWA 19.146.200 () (12) "Mortgage broker" means any person who for compensation or gain, or in the expectation of compensation or gain (a) makes a residential mortgage loan or assists a person in obtaining or applying to obtain a residential mortgage loan or (b) holds himself or herself out as being able to make a residential mortgage loan or assist a person in obtaining or applying to obtain a residential mortgage loan. West's RCWA 19.146.010 ()	**Regulator:** Department of Financial Institutions First mtg lenders will come under the broad definition of "mortgage brokers" while second mtg lenders are covered by Consumer Loan Act Links: www.dfi.wa.gov Mortgage Broker Practices Act

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		No person may engage in the business of making secured or unsecured loans of money, credit, or things in action at interest rates authorized by this chapter without first obtaining and maintaining a license in accordance with this chapter. West's RCWA 31.04.035 ()	
West Virginia	**Yes**	(a) No person shall engage in this state in the business of lender, broker or loan originator unless and until he or she shall first obtain a license to do so from the commissioner, which license remains unexpired, unsuspended and unrevoked, and no foreign corporation shall engage in business in this state unless it is registered with the secretary of state to transact business in this state. W. Va. Code, § 31-17-2	**Regulator:** Division of Banking Links: www.wvdob.org Regulation of Mortgage Brokers, Lenders, Servicers and Loan Originators Act www.wvdob.org Consumer Credit Protection Act
Wisconsin	**Yes**	**(1m) Registration required.** A person may not act as a mortgage banker, loan originator or mortgage broker, use the title "mortgage banker", "loan originator" or "mortgage broker", or advertise or otherwise portray himself or herself as a mortgage banker, loan originator or mortgage broker, unless the person has been issued a certificate of registration from the division. W.S.A. 224.72	**Regulator:** Department of Financial Institutions Links: www.wdfi.org Mortgage Bankers, Loan Originators and Mortgage Brokers Act
Wyoming	**Yes**	(a) With the exception of those persons exempt pursuant to W.S. 40-23-105, on and after July 1, 2005, no person shall engage in mortgage lending activities or mortgage brokering activities without first obtaining a license in accordance with this act. WY ST § 40-23-104	**Regulator:** Department of Banking Links: http://audit.state.wy.us/banking/ Residential Mortgage Practices Act http://audit.state.wy.us/banking/ Uniform Consumer Credit Code

Attachment 6

BY STEPHEN GANDEL AND AMANDA GENGLER WITH PAUL KEEGAN | ILLUSTRATIONS BY ANASTASIA VASILAKIS

Scenes from a

Wondering how home prices got so high—and why they now have to fall? Here's the story of what hit you: an amorality play in four acts.

Newlyweds Erik and Brandi Quam can't really afford their home. The monthly carrying costs on their two-bedroom condo in Arlington, Va. run about $2,500 a month, and they fear the bill could go higher still as their adjustable mortgage resets to higher interest rates. It's already a tight squeeze: They've taken in a roommate to help pay the bills. Unfortunately, they can't afford to sell either. Thanks to a falling housing market and a prepayment penalty of about $11,500, they'd owe the bank more than their place is worth. "It makes me want to cry every month," says Brandi, 26. The irony is that the Quams should be able to afford their place: It cost just $219,000 when a still-single Brandi, fresh out of the Air Force, bought it.

So how did they get themselves in such a mess? More puzzling still, why did lenders let them—along with millions of other homeowners, many of whom, unlike the Quams, are in immediate danger of foreclosure?

In the answer to that question lies the real story behind the once dizzying, now fizzling housing boom. Sure, record-low interest rates, boomers buying vacation homes and immigrants grabbing for the American dream all did their bit to push up prices. But what really supercharged the market was the mortgage industrial complex—a machine with cogs called brokers and bankers, fueled by money poured in by investment banks, bond traders and hedge fund managers. The system prospered and grew, introducing new players into the financing transaction and transforming the roles of others. Finally it ran amok, creating huge incentives at every level of a home sale or a refi to sacrifice prudence in pursuit of a killing. Market checks and balances should have prevented the process from getting out of control. But they were corrupted, co-opted or simply steamrollered. For example:

➔ The lending officer of old, who often worked for a bank that underwrote the loan, was replaced by the mortgage broker. Loosely regulated and employed by a company with little or none of its own capital at stake, brokers are salespeople rewarded for steering as many prospective homeowners or refinancers as possible into the most profitable loans.

➔ Appraisers, who are supposed to be the independent gatekeepers of the mortgage system, increasingly caved in to pressure to approve any deal a broker or loan officer wanted to make.

➔ Lenders, in turn, had less and less reason to care whether the borrowers could repay. No longer did a bank have to hold a loan itself or sell it into a secondary market of cautious investors. In the super-low-interest-rate environment of recent years, Wall Street would buy just about any loan, however risky, to gain a little extra yield. To meet demand, lenders spun out a crazy profusion of mortgages that would allow more borrowers to qualify for ever-larger amounts. If a borrower might not really be able to afford the payments...well, the lender had already sold the loan off. "The mortgage market for the past few years has been playing a massive game of hot potato," says Drexel University finance professor Joseph Mason.

➔ Borrowers, to the extent that they understood what they were getting into, also played along. In a market that kept rising, getting your dream house seemed to make sense. A broker could find you a loan with monthly payments you could handle—at least at first. And soon enough you'd sell and pocket a big gain.

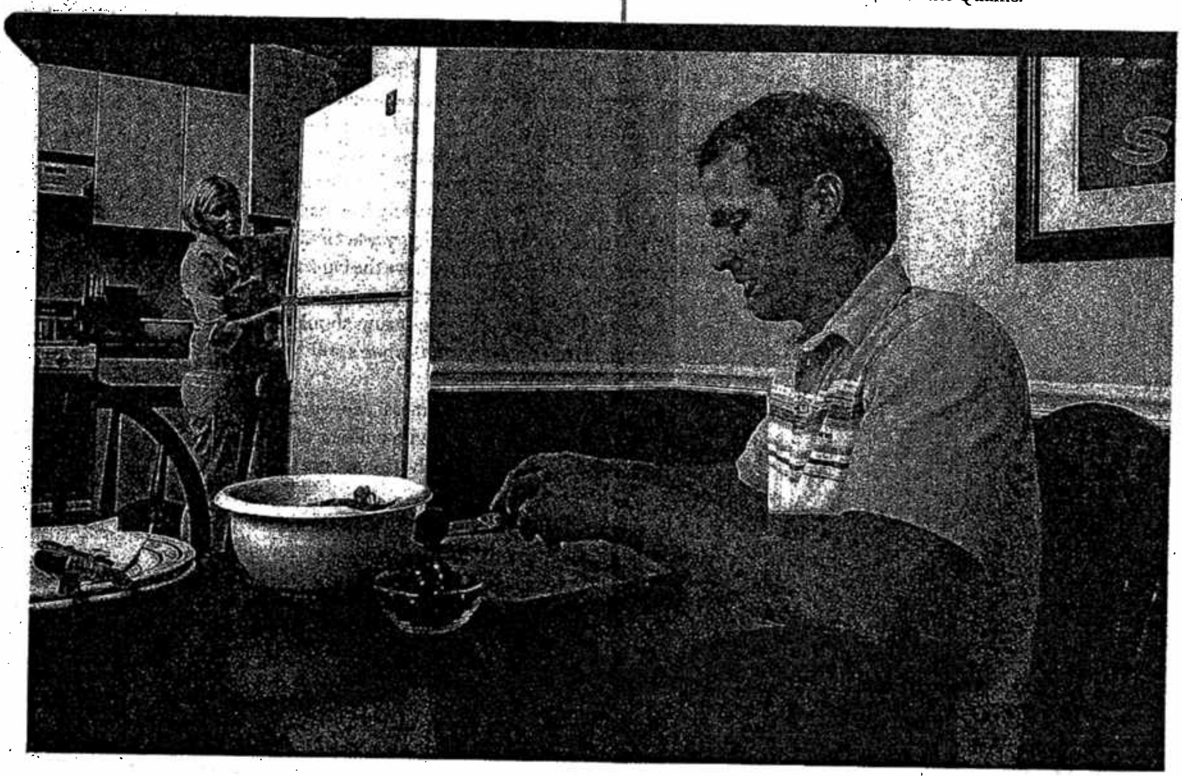
"The mortgage market for the past few years has been playing a massive game of hot potato," says one financial expert. Now the music has stopped.

Too much money. Too little restraint. This is the story of how all the important players in the market decided that they had too much at stake to shout, "Stop!" We've been here before: Remember when Wall Street analysts told us Amazon.com was worth $400 a share? And as with the tech bubble, it may not be only speculators who get hurt. As home prices unwind from unsustainable highs, we may all feel at least a little bit poorer. That could be a drag on the economy. It's already a real drag for the Quams.

ACCIDENTAL LANDLORDS

Brandi and Erik Quam

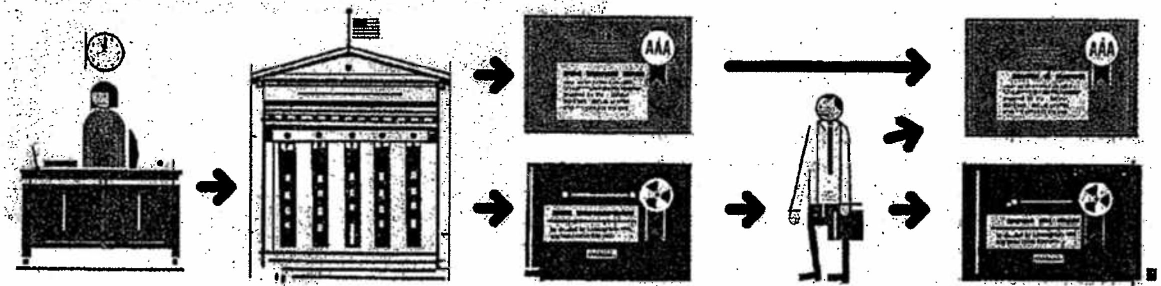
Stretched by their loan, the newlyweds rented out their second bedroom to help pay the bills.



PHOTOGRAPH BY MAX HIRSHFELD

Who Really Owns Your House?

Why are banks so willing to make mortgages that would be hard to pay back? Because Wall Street allows them to spread the risk to other investors. Here's how a mortgage might change hands.



1 You get your mortgage from a bank, which sells it to...

2 ...a big Wall Street investment firm. That company combines your loan with other mortgages to create...

3 ...bonds of high and low credit quality. Investors snap up the good stuff. Bonds backed by risky loans end up with...

4 ...a bond manager, who bundles them together again. Via some financial alchemy he creates new securities, including...

5 ...more bonds with high credit quality. Some low-quality, risky bonds are still left over. A hedge fund might buy those.

> "Option ARMs are not a license to steal," says one broker. "But once a customer asks for it, I know I am going to make four times as much money."

The Buyers

ARLINGTON, VA.

The Quams and the too-good-to-be-true mortgage

The primary mortgage on the Quams' condo was fixed at 5.25%. But Brandi had also taken out a smaller variable-rate loan. As rates rose in 2005, she went looking for a better deal and entered her contact information into a few websites. Shortly thereafter, she says, she got a call from broker Robert Hoover of CPA Mortgage in Maryland. He found her a new loan with what she says she understood to be an initial 1% rate, with only small increases in the first five years. And since she had equity (her condo had appreciated), she could even take a little cash out to pay off some bills. The transaction earned the broker and his firm about $12,600.

It took a few months before Brandi realized what she had done. The mortgage was something called an option ARM. It was true that Brandi could make initial minimum payments of about $800. But those weren't enough to cover the interest she was actually being charged, which was higher than the rate used to calculate required payments. The unpaid interest was added to the loan balance, a phenomenon called negative amortization. The Quams have decided to start paying at least the interest on the loan, but even so, the balance has grown by $7,000. Barring a market turnaround, they're stuck for at least another year and a half until the prepayment penalty phases out. They've had to turn down job offers because they can't move.

Who is to blame here? Yes, Brandi should have asked more questions and scrutinized the fine print. The idea of a mortgage with a 1% rate seems, on its face, too good to be true. Brandi says she did know she'd eventually have to make higher payments, but she planned to move before that happened. Exactly how Hoover described the mechanics of the loan, or what she thought he meant, is impossible to know for sure now. Hoover declined to speak with MONEY, and his firm sent an e-mail saying that it couldn't comment on a client but that "ultimately, it is the consumer that makes the choice they feel is best."

But based on the documents Brandi showed us for her loan—and documents MONEY has seen for other option ARMS—it is easy to see how a person could be confused. A payment schedule is shown on the federally mandated truth-in-lending form, but it is based on minimum payments and a steady interest rate, rather than the variable rate the Quams are charged. An "adjustable-rate note" first says the Quams will be charged a yearly rate of 1%. The next subsection says that rate "may" change almost immediately. The first payment coupons show only the minimum, negatively amortizing payment.

A spokeswoman for the original lender, BankUnited of Miami Lakes, Fla., said she couldn't specifically comment on Brandi's loan. But she said that borrowers aren't approved unless their "credit score will support the fully indexed rate." All borrowers, she added, acknowledge receipt of numerous documents disclosing every aspect of the loan, including a four-page form that describes the terms "in plain English" and warns borrowers of the possibility of negative amortization.

Keep in mind, complex loans like option ARMs are new to most people, and they are radically different from 15- and 30-year fixed-rate loans. Consumer advocates say that the truth-

ILLUSTRATION BY RAYMOND BIESINGER

in-lending disclosure rules are outdated and that borrowers like the Quams are being asked to climb a steep learning curve—with their homes at stake. "The disclosures on adjustable-rate mortgages have never been any good, and option ARMs are particularly terrible," says Jack Guttentag, professor emeritus of finance at the University of Pennsylvania's Wharton School.

In any case, the loans are popular. In the first half of 2006, option ARMs were 15% of mortgage originations, reports the Mortgage Bankers Association. In theory, the loan can be a useful tool for people with irregular income, such as entrepreneurs. But low payments are the rule, not the exception. Today more than 80% of borrowers in securitized option ARMs pay less than their interest charges, according to Fitch Ratings. Their loan balances are rising. That might not be so bad in a rising market, but it's potentially a disaster in a falling one.

It's obvious that a lot of homeowners could have used better advice about how to find an affordable loan. But good advice has gotten harder to come by in the mortgage game. That's because the person across the desk or on the other end of the telephone getting you a mortgage probably doesn't work for the bank that's putting up the money. He may not care if you can pay. "Consumers thought that when they qualified for a loan, that meant they had a reasonable prospect to repay the loan unless some type of illness or catastrophe hit the family," says Michael Calhoun, president of the Center for Responsible Lending. "That is no longer the case."

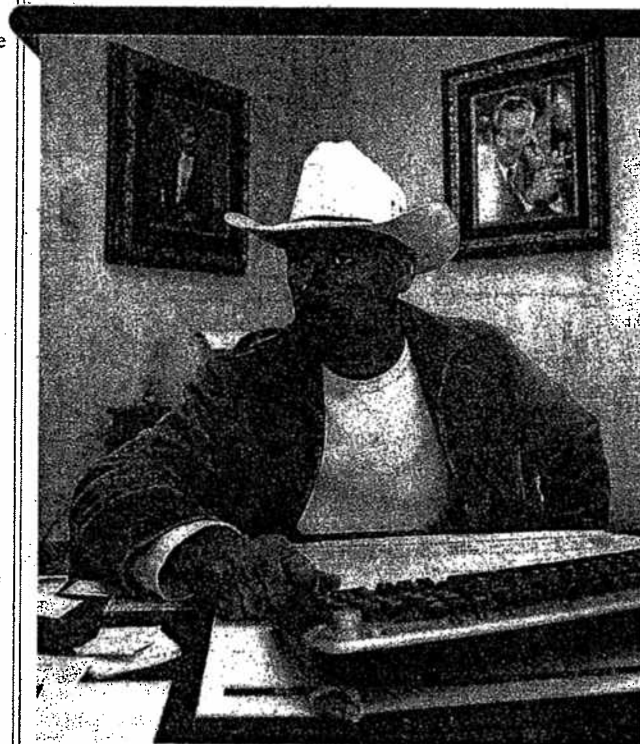
The Brokers

ATLANTA

Would you get your mortgage from this man?

Morning commuters in Boston, Chicago and Phoenix are slapped awake by the voice of a pugnacious Texan shouting out of the radio. "When your mortgage payment goes up 400 bucks a month, you can dislocate your jaw and swallow it like a snake eatin' an egg," the voice says. "Or spend another seven grand and have some predator redo your mortgage. Unacceptable." The voice belongs to Jon Shibley, 39, the president of Lenox Financial Mortgage. Over 13 years he's built his business from a one-man shop in Atlanta into a 200-employee company that arranges mortgages and refinancings in 24 states.

Up until the 1980s, when the savings-and-loan crisis brought the old system crashing down, getting a mortgage typically meant sitting down with a loan officer from a local lender, which cared a lot about your ability to pay. Today about 70% of mortgages are originated by a mortgage broker. It's an intense, fast-moving business and suits the hypercharged Shibley just fine. Shibley meditates 20 minutes a day but also claims that he will occasionally burn himself or immerse his body in ice water—"a shock to the system," he calls it, that keeps him engaged. Shibley doesn't rely on word-of-mouth or community roots. He drives his business with in-your-face advertising. These days, as his commercials show, his sales targets include borrowers looking to escape onerous payment hikes on their variable-rate mortgages. "People don't know who to call," he says. "That's why my marketing philosophy has been so successful."



SALES DRIVER
Jon Shibley
"This industry is a disaster," says the mortgage broker. And he'll tell you so on the radio.

For better and for worse, the new mortgage sales machine made it much easier to get a loan. And if a mortgage option was mathematically possible, a broker made sure you knew about it. He or she could get you a low annual rate, help you avoid a down payment or find you a super-low initial monthly payment. Shibley's particular pitch is "no closing costs," which looks to be an easy sell to borrowers suddenly short on cash. "This industry is a disaster," he says. All these mortgage options can make sense in certain circumstances and hurt you in others. (You may actually prefer to pay closing costs, for example, if that gets you a lower rate and you plan to stay in the loan long enough to work off the costs.) The tricky part is figuring out which loan works for you.

A good mortgage broker can help you do that, and Shibley says that's what his people do. But not all brokers will. Brokers can be paid more if they can convince you to pay a higher rate than you qualify for, or borrow more money than you need. And they resist efforts by lawmakers to give them a fiduciary obligation to act in the borrower's best interest. "We do not solely represent the consumer," says George Hanzimanolis, president-elect of the National Association of Mortgage Brokers.

In short, it's best to shop around—and it's easy enough to do that on a basic fixed-rate mortgage. It's a lot harder to comparison-shop loans with payment options and variable rates, which is why brokers love to sell them. With option ARMs, borrowers tend to focus on the introductory rate and minimum payment, and to ignore the higher rate down the road. For the broker that higher rate could mean the difference between a $3,000 commission and one several times as large. "Option ARMs are not a license to steal, but once a customer asks for it, I know I'm going to make four times as much," says Jim Moore, a Grand Rapids broker who writes about his business at miamibeach411.com, speaking by cell phone. "It's what puts me down here at Best Buy buying a 40-inch flat screen."

Even then there are usually limits to how much your broker can get out of you. After all, a mortgage is based on the value of your house. But maybe there's a way around that too.

Minimum Payment, Maximum Danger

If you make only the minimum payment on an option ARM, you fare worse than in a traditional mortgage.

STARTING POINT

$270,000 mortgage on a
$300,000 home
= **$30,000** in equity

YOU PAY

$868 to **$1,004** on an option ARM for three years
or **$1,887** on a 30-year fixed mortgage

YOUR EQUITY IN THREE YEARS IF THE HOME'S PRICE...

drops 10%		jumps 10%	
OPTION ARM	30-YEAR FIXED	OPTION ARM	30-YEAR FIXED
–$28,582	$8,602	$31,418	$68,062

NOTES: Assumes minimum payment based on a 1% rate, increasing 7.5% per year. Assumed rate on option ARM is 1% in first month and 7.5% thereafter; assumed rate on traditional mortgage is 7.5%. In real life, an option ARM charges a variable rate, so equity could be higher or lower. Figures do not account for transaction costs, which would lower the true value of any equity.
SOURCE: mtgprofessor.com.

"Under the current system there is really no point to an appraisal anymore," says one of the nation's biggest appraisers. He wants tougher laws.

The Appraisers

SAN LEANDRO, CALIF.

Price estimates made to order

Last summer Daniel Kim was feeling pinched. So when Kim, now 27, of San Leandro, Calif. got a call from a mortgage company, he was intrigued. The loan officer, Mia Yi of ALG Capital, sold Kim on refinancing, putting him an additional $81,000 in debt on his house. Kim says he was surprised he could borrow more. He had bought the two-bedroom the previous year for $560,000 with no money down, and everything he had read said the market in his area was cooling. But after Yi produced an appraisal in November that said his house was worth $642,000, Kim signed. "I was excited," he says, "that my house had appreciated that much."

Appraising the value of a house has never been an exact science. But the $4-billion-a-year appraisal industry provides a crucial reality check for the system. Banks need an appraisal to make a loan. Regulators and mortgage investors require it to insure against fraud. Consumers rely on appraisals to give them some measure of confidence they aren't paying too much. In refinancings, the appraisal is the only thing that tells a consumer what a house is worth and how much he can borrow.

So perhaps it's not surprising that appraisers have come under pressure from some of the people selling mortgages. MONEY has obtained more than 100 e-mails and faxes sent by loan officers to appraisers across the country. The language varies from asking if a predetermined value was possible to promising more business if a number could be hit. "Many homeowners are finding out that the equity they were led to believe they had in their house is not actually there," says John Taylor, president of the National Community Reinvestment Coalition.

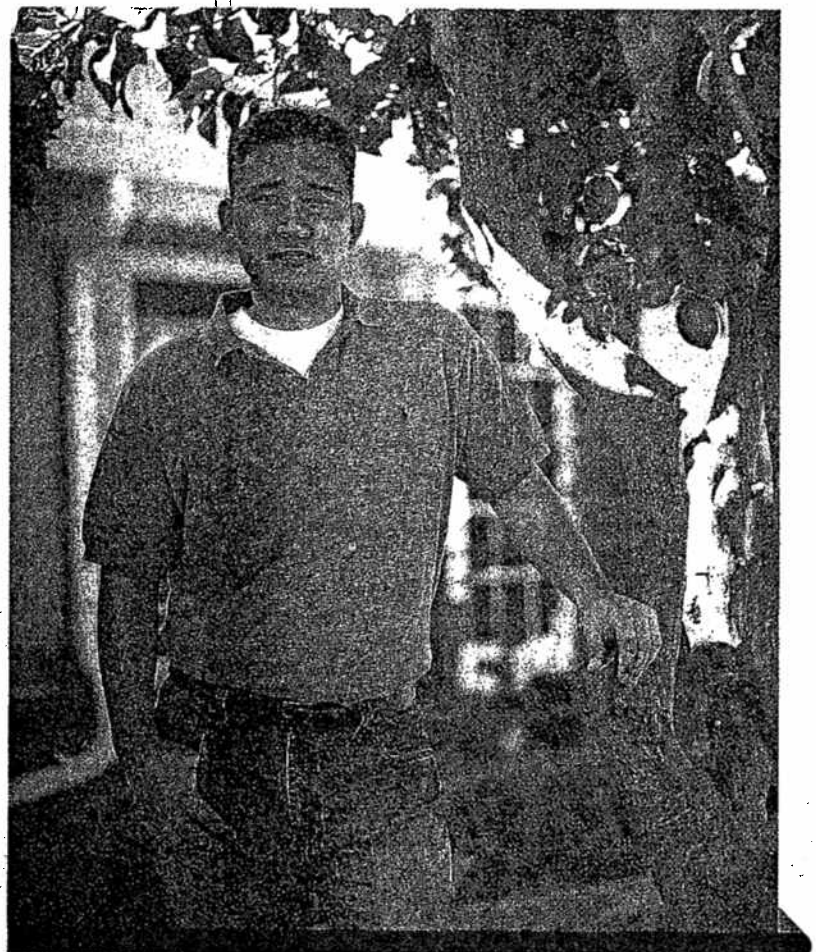
According to an appraiser MONEY hired, Kim's house is worth only $580,000 and was at the time he refinanced the house. Yes, different appraisers often have different takes. In Kim's case the appraisers disagree about whether an enclosed porch counts as part of the total square footage. But ALG's Yi strongly suggested to appraisers what the answer ought to be. In an e-mail she sent to numerous appraisers, Yi said she needed "a value of $650,000 or more. Please let me know ASAP with max value." Five days later Paul Chasteen, an appraiser in

PHOTOGRAPH BY GREG FOSTER

Discovery Bay, produced the appraisal that led to Kim's $642,000 mortgage, less than Yi wanted but enough to do a deal. ALG got him loans for the full appraised value. The result: Kim now owes $62,000 more than his house may be worth. Kim put the money from the refinancing into a dry-cleaning business and paying off a car loan. He can't move without foreclosing. "It's not a good feeling," he says.

Yi declined to comment. ALG owner Crystal Palomino said two appraisers (from the same firm) reviewed the value, as did the funding bank. Chasteen says he and his fellow appraisers are under the gun because as many as 10 competitors may get the same order. Referring to that pressure, Chasteen says, "Is there a problem out there? You bet there is." He adds, though, that he resists and that in Kim's case pressure wasn't an issue. "I never push values," he says.

Appraiser Ray Miller of Lyndon Station, Wis. also says he doesn't inflate values but complains that he is asked to do so daily. Miller says he doesn't always give the preferred answer, which hurts business. "If I don't hit the number they are asking for, I almost never hear from that loan officer again," he says. "But if you don't accept these orders at all, you won't have any business."



IT'S WORTH *HOW MUCH?*
Daniel Kim
He doubts he can sell his home for what it appraised for, and now he's stuck there.

Brokers sometimes ask for a "comp check." They don't ask for a target price, but get a number of appraisers to guess what a property is worth, sight unseen, before ordering. "Appraisers who do comp checks know that they have to inflate values to get the order and get paid," says Pamela Crowley, a former appraiser who recently launched a site to catalogue lending abuses, MortgageFraudWatchList.org.

Hanzimanolis of NAMB says appraisal pressure isn't a big problem. His organization amended its code of ethics last year to prohibit members from squeezing appraisers. "I don't see how anybody but the appraiser is responsible for an inflated or fraudulent appraisal," he says.

A number of states, including Colorado, are mulling laws that would make it clearly illegal to pressure appraisers. Jonathan Miller (no relation to Ray), owner of New York City's Miller Samuel and one of the nation's most prominent appraisers, argues that such laws are sorely needed. "Under the current system," he says, "there is really no point to a mortgage appraisal anymore." You might expect that those ultimately on the hook if a borrower fails to pay would take an interest in making sure that the collateral was really worth its appraised value. But until the past few months, you'd have been wrong.

The Investors

KEY BISCAYNE, FLA.

How to get rich trading "idiot" loans

The housing boom was good to John Devaney. Really good. He owns a Rolls-Royce, a Gulfstream Jet, a 12,000-square-foot mansion in Key Biscayne and a 143-foot yacht, as well as a few Renoirs and a valuable 1823 reproduction of the Declaration of Independence. Devaney's not a developer, and he's certainly not a flipper. The 36-year-old CEO of United Cap[illegible]al Markets is

PHOTOGRAPH BY SHELLY STRAZIS

a bond trader. And one of his specialties is buying and selling bonds that are backed by the mortgage payments of ordinary homeowners. Option ARMs? Devaney loves 'em. "The consumer has to be an idiot to take on those loans," he says. "But it has been one of our best-performing investments."

Devaney's not out to get people into bad loans—or into good ones. He just makes bets on how many people will repay and when. Still, the $5.7 trillion mortgage-backed-securities market had a key role in today's housing mess. "The broker and the lender and everybody else in between is part of a factory that's producing bond securities for Wall Street," said attorney and consumer advocate Irv Acklesberg in testimony before a Senate committee recently. On the other hand, the fact that Devaney and other investors are willing to own mortgages may also be one of the reasons you could afford your house.

Banks have been selling off their mortgages to the bond market since the 1970s. Bond investors get the borrowers' monthly payments and the promise that they will be paid back, while banks get immediate cash and the chance to unload some risk. All this makes it easier for them to make new loans—good news for most borrowers. The trouble is, Wall Street's rocket scientists keep finding more sophisticated ways to repackage and resell mortgages. As a result, lenders stopped worrying so much about credit standards and learned to love risky loans.

Look, for example, at the financial Frankenstein's monster known as the collateralized debt obligation, or CDO. Brought to life in the 1990s, the CDO helped solve a knotty problem for lenders. They were often left holding a small amount of loans that were too dodgy to sell to investors at an attractive price. But what if you grouped the payments from all those risky mortgages together, along with some other investments, and you sold some investors the right to be the first ones to get paid? This would look like a relatively safe investment, and so—voilà!—you've transformed a risky loan into a triple-A rated security. Other investors would be farther back in line and might not get paid if things went badly. But you could offer those investors very high yields, so that hedge funds and pension funds would roll the dice.

This set the whole mortgage-bond sector on fire. Banks rushed to make mortgages—any kind of mortgages. Lousy credit? No problem. Can't prove your income? No problem. Can't pay more than 1% now? No problem.

Matthew Porter (right)

THE BUCK STOPS HERE (BRIEFLY)

John Devaney

The investor has made a fortune trading bonds backed by mortgages.

Now a lot of that lending looks foolish. Mortgage delinquencies among so-called subprime borrowers have risen to 13%, the highest in at least 10 years. The market for the lowest-credit-quality mortgage bonds has tanked. And investors in CDOs may be in for a rude shock. "Some of the investors who bought CDOs certainly took on more risk than they thought," says John Weicher, a former assistant secretary of housing now at the Hudson Institute. But Devaney, who told a crowd of investors that the riskiest mortgage bonds looked "awful" before the crash, says he thinks he'll be buying. "I don't believe the carnage and fallout will be as bad as people think," he says.

Whether or not big investors come out okay, the damage is done for many homeowners. "The system allowed banks to create unsustainable loans that are going to haunt borrowers for years to come," says Allen Fishbein, director of credit and housing policy at the Consumer Federation of America. "Unlike the bank, the borrower has no way to lay off the risk."

What comes next? The pullback. Investors will be more selective about where they put their money, and banks will be more cautious in their lending. That's basically healthy. But the risk is that this will happen so fast that we'll see a vicious circle develop: Falling home prices mean less credit, and less credit means fewer buyers and, hence, falling home prices. That could make a housing recovery that much harder to come by. For the Quams, one can't come soon enough. "I worked so hard to be a homeowner, and now my dumb decision with this loan may take it all away," says Brandi. "We are newlyweds, bleeding money like crazy, and there are no Band-Aids." $

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Who sold you your mortgage

It probably wasn't a banker. More and more often it's a mortgage broker.

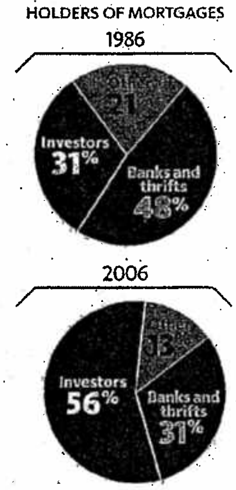
MORTGAGES ORIGINATED BY BROKERS

1987	2004
20%	**68%**

Who owns your mortgage

It's probably not your bank. More and more often it's the bond market.

HOLDERS OF MORTGAGES



NOTES: Banks and thrifts also includes credit unions. Investors includes asset-backed bonds and pools of government agencies and government-sponsored enterprises. Other includes finance companies, corporations, government and households. SOURCES: Wholesale Access, Federal Reserve.

Attachment 7

TESTIMONY OF

JOHN W. RYAN

CONFERENCE OF STATE BANK SUPERVISORS

Before the

STATE OF INDIANA

INTERIM STUDY COMMITTEE ON MORTGAGE LENDING PRACTICES

AND HOME LOAN FORECLOSURES

October 11, 2007
Indianapolis, Indiana

Introduction

Good morning, Madame Chairwoman and distinguished members of the Committee. My name is John Ryan, and I am the Executive Vice President of the Conference of State Bank Supervisors (CSBS). I am pleased to be here today to discuss the very important work of this study committee and state and federal efforts to improve mortgage lending regulation and oversight.

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's 6,206 state-chartered commercial and savings banks, and 400 state-licensed foreign banking offices nationwide. For more than a century, CSBS has given state bank supervisors a national forum to coordinate, communicate, advocate and educate to support state bank regulation.

In addition to regulating banks, all 50 states plus the District of Columbia now provide some form of regulatory oversight of the residential mortgage industry. Under state jurisdiction are more than 90,000 mortgage companies with 63,000 branches and 280,000 loan officers and other professionals.[1] In recent years, the states have been working diligently to improve supervision of the residential mortgage industry. Despite these ongoing efforts, there are numerous problems in the mortgage lending system significantly impacting consumers in this country as evidenced by the need for this Committee's hearing today.

The United States did not arrive at the current disarray in the residential mortgage market overnight and no single party is fully responsible for our current situation. CSBS believes the rapid and dramatic changes in the industry through increased use of

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[1] The above numbers do not include the State of California's Department of Real Estate's approximately 480,000 licensed real estate agents who could also function as a mortgage broker under their license.

securitization and technology created a more fractured industry with less direct accountability for loan originators and lenders. States stepped in to act as the primary regulator as the industry evolved outside the borders of traditional bank regulation. However, the responses in the creation in state regulation were uneven from state to state, often under-funded and sometimes hampered by federal preemption. State regulators do not eschew responsibility, but Congress, federal regulatory agencies, mortgage lenders and brokers, insured depository institutions, and borrowers must all accept a measure of responsibility for aiding in the creation of our current residential mortgage marketplace.

In my testimony I will address the recent evolution of the residential mortgage market and current developments of state/state and state/federal supervisory coordination. Specifically, I will discuss state efforts to develop a nationwide licensing system for mortgage professionals, consistent education requirements for mortgage professionals, best practices for examination of state licensed brokers and lenders, and simplified disclosures for consumers. Additionally, I will review the coordinated state and federal efforts to develop guidelines for nontraditional and subprime lending and joint and coordinated supervision of nonbank mortgage lenders and brokers. Finally, I will give an overview on the prospects for federal legislation that would impact state authority.

Evolution of the Residential Mortgage Industry

The changes in the residential mortgage industry over the past twenty years have been dramatic and far-reaching. The mortgage market now has a bigger impact on the economy as a whole, has ushered in new players, and has created an explosion in product choices.

The volume of loan originations has increased drastically over the past two decades. This increase in loan volume was facilitated in part by advances in technology, such as the automated underwriting systems, the increase of mortgage products available to the consumer, the evolution of the subprime market, and an expansion of the holders in the secondary market for mortgage securities, including international investors, hedge funds, and private equity funds.

Twenty years ago, federal and state regulated savings and loans originated most of the residential mortgages. Federal government-sponsored enterprises (GSEs) or agencies such as Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA) held a significant percentage of the market share and effectively set standards for the entire industry. Subsequent to the savings and loan crisis in the late 1980s, the origination of mortgage loans shifted primarily to mortgage brokers and mortgage lenders.

Mortgage brokers and lenders are not a product of state government. However, state regulation, supervision and enforcement of the mortgage industry are creations of state government. Initially, these providers were unlicensed. But as the market grew, the number of players increased, and practices evolved, the states began requiring registration and licensing of mortgage-industry service providers. The state regulatory agencies are responding to the needs of the residential mortgage industry and mortgage consumers.

Some industry observers have referred to our current situation as a "broker problem." Certainly, the marketing and sales practices of mortgage lenders and brokers, as well as increased accountability, need to be addressed. However, a mortgage broker is only as good as his or her ability to obtain funding for a loan. To that regard, in recent years the majority of loans originated by mortgage brokers and lenders at the local level are in fact ultimately financed by Wall Street firms that operate at a global level.

The mortgage revolution has brought with it a number of good things: a vast flow of liquidity into the mortgage market, increased availability of mortgage credit, more consumer choices, and higher rates of homeownership. It has also brought moral hazard, as the allocation of risk of a mortgage loan default became dispersed through complex contractual arrangements that began with the local mortgage broker, and ultimately ended with a Wall Street investor. This dispersal of risk created opportunities and incentives for some actors to engage in weak underwriting or fraud. As a result, there have been significant increases in fraud and foreclosures.

CSBS and state regulators believe this increase in product choice and loan characteristics, if understood, is beneficial to consumers. An expanding variety of products and loan options should increase the likelihood that a consumer will purchase a loan that best fits their unique financial situation. CSBS and state regulators are concerned, however, that the confluence in the past few years of weak to nonexistent underwriting standards with an influx of complex and poorly understood products offered to subprime borrowers have sowed the seeds of disaster for many of our most vulnerable communities. Making matters more difficult for state legislatures and regulators in establishing appropriate policy is the complexity of legislating and regulating when many in the industry are exempted from state law because of federal preemption. Additionally, while product offerings were increasingly complex, until recently, federal attempts at consumer disclosure seemed more geared toward protecting lender liability than providing clarity for consumers.

Fortunately, there is a new and growing awareness at the state and the federal level that we need a more coordinated state/federal system to improve consumer protection and connect the gaps and failings of the regulation of the mortgage industry. States are focusing efforts to improve regulations of lenders and brokers not subject to federal supervision through enhanced licensing requirements, and by dedicating more resources to enforcement and supervision of previously unregulated entities. State bank and mortgage regulators have also been coordinating with federal banking regulators on the development and application of nontraditional and subprime lending guidance, so that standards apply equally to all mortgage service providers whether they are state or federally regulated.

State Regulatory Advancements

For years, the state banking system has been the laboratory for innovation and for developing the best practices in products and services and consumer protection. The states are best positioned to serve this role because it is at the state level that both businesses and consumers have proximity, access, and accountability from their regulatory agencies.

The actions taken by the states in response to the evolving mortgage market have focused on protecting consumers through development of licensing and supervision of mortgage brokers and lenders, legislation, and enforcement of consumer protection laws. Each day state regulators take enforcement actions against mortgage lenders and brokers for abusive lending.

As previously noted, the residential mortgage industry as we know it is relatively young. It has evolved and expanded rapidly. This change in the market has forced state regulators to adapt, innovate and increase capacity. But state bank supervision has existed since the late 1700's and has a history of adapting to changes in the market. With the help of state legislatures, state mortgage supervision can continue to grow and improve.

Recognizing, however, that many mortgage lenders and brokers operate on a multi-state or nationwide basis, the states, through CSBS and the American Association of

Residential Mortgage Regulators[2] (AARMR), are developing cooperative initiatives and tools to more effectively regulate the marketplace.

CSBS-AARMR Nationwide Mortgage Licensing System

On a nationwide scale, CSBS has partnered with AARMR to ensure that consumers are protected from fraudulent practices and receive adequate information regarding mortgage service providers. Over two years ago, CSBS and AARMR embarked on an initiative that will change the world of mortgage supervision. CSBS and AARMR are creating a nationwide mortgage licensing system to improve the efficiency and effectiveness of the U.S. mortgage market, to fight mortgage fraud and predatory lending, to increase accountability among mortgage professionals, to inform consumers, and to unify and streamline state licensing processes for lenders and brokers.

The licensing system will be a web-based system that will allow lenders and brokers to apply for, amend, update or renew a license using uniform forms from participating state agencies. The system will also collect licensing fees at the time of application or renewal and disburse these to the respective state agencies.

Scheduled to begin operations on January 2, 2008, this system will create a single record for every state-licensed mortgage company, branch, and individual that will be shared by all participating states. This single record will allow companies and individuals to be tracked across state lines and over any period of time.

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[2] AARMR is the national organization representing state residential mortgage regulators. AARMR's mission is to promote the exchange of information between and among the executives and employees of the various states who are charged with the responsibility for the administration and regulation of residential mortgage lending, servicing and brokering.

A total of 38 states, including Indiana, have announced their intent to participate in the system by the end of 2009. CSBS expects several more states to announce their similar intent over the coming months. It is expected that 4-6 state agencies will transition onto the system each quarter during 2008 and 2009. Each state will announce its participation date and communicate with licensees in advance of its participation onto the system.

Each company licensee will become credentialed for system access and enter its company, branch and/or loan officer information for the first participating state in which it is licensed. Once this record is created in the system, there will be no need for the licensee to input a new record when another state in which they are licensed begins participation in the system. Correspondingly, once in the system, a loan officer will only update his/her employer affiliation when he/she moves to a new company. The licensee will merely have to access their record in the CSBS/AARMR system and apply it to the new state or have the new company use the record in the system to establish a relationship.

State mortgage regulators began discussing ways to bring more accountability and uniformity into state mortgage licensing beginning in 2003. In January 2005 regulators began meeting on a monthly basis to create uniform license applications and began actual development of the nationwide licensing system. In late 2006 state mortgage regulators began using the paper versions of the uniform. Currently about a dozen state agencies are using the uniform paper forms.

CSBS and AARMR have also engaged mortgage lenders and brokers in the development process and have organized an Industry Development Working Group. This group has met several times since the summer of 2006 to provide input on the MU Forms and other system development issues.

This nationwide licensing system will also provide consumer access to a central repository of licensing and publicly adjudicated enforcement actions. This will allow homebuyers a central place to check on the license status of the mortgage broker or lender they wish to do business with, as well as a way to determine whether a state has taken enforcement action against that company or individual.

The system will provide important benefits to state regulators, the mortgage industry, and the home-buying public. Most significant the system will increase the accountability of mortgage companies and mortgage professionals and assist the regulatory agencies in keeping bad actors out of the mortgage business. It will be more difficult for those who wish to use the mortgage industry to victimize consumers to enter or operate within the industry.

In June 2006, CSBS contracted with the National Association of Securities Dealers, Inc. (NASD) to develop this system. The NASD developed and now operates two nationwide systems in conjunction with or for state regulators: the securities industry Central Registration Depository (CRD) ® and the financial planning and investment advisor industry Investment Adviser Registration Depository (IARD) ® system. The NASD brings significant expertise in developing and operating nationwide licensing systems that are subject to state regulations.

Each state will continue to retain its authority to license and supervise, but the new system will eliminate unnecessary duplication and implement consistent standards and requirements across state lines. Additionally, the state agencies will be able to divert resources previously used for processing applications to more supervision and enforcement.

The system will provide immediate and profound benefits to consumers, the industry, and the state supervisory agencies. Consumers will have access to key information about the providers that they trust with the most important financial transactions of their lives. Honest mortgage bankers and brokers will benefit from the creation of a system that drives out fraudulent and incompetent operators, and from having one central point of contact for submitting and updating license applications. Everyone benefits from a secure electronic system that is more efficient and makes it easier to identify and punish the small percentage of dishonest operators in the mortgage industry.

Uniform Standards for Testing and Education

Another major initiative where states are leading is in the development of education and testing requirements for mortgage professionals. CSBS and AARMR are spearheading a cooperative project of 23 state regulatory agencies called the Mortgage Industry Nationwide Uniform Testing and Educations Standards (MINUTES). This initiative, begun early this year, will establish acceptable uniform standards and streamline the process for licensees to comply with these standards. MINUTES will ensure that licensed mortgage providers are held to the same standards and expectations, regardless of the state in which they make loans.

State Enforcement of Consumer Protection Laws

In addition to the extensive regulatory and legislative efforts, state attorneys general and state regulators have cooperatively pursued unfair and deceptive practices in the mortgage market. Through several settlements, state regulators have returned nearly one billion dollars to consumers. A settlement with Household resulted in $484 million paid in restitution, a settlement with Ameriquest resulted in $295 million paid in restitution, and a settlement with First Alliance Mortgage resulted in $60 million paid in restitution. These landmark settlements further contributed to changes in industry lending practices.

But successes are sometimes better measured by actions that never receive media attention. States regularly exercise their authority to routinely examine mortgage companies for compliance not only with state law, but with federal law as well. These examinations are an integral part of a balanced regulatory system. Unheralded in their everyday routine, examinations identify weaknesses that, if undetected, might be devastating to the company and its customers. State examinations act as a check on financial problems, misapplication of consumer protections and sales practices gone astray. Examinations can also serve as an early warning system of a financial institution conducting misleading, predatory or fraudulent practices. Attached as Exhibit B is a chart of enforcement actions taken by state regulatory agencies against mortgage providers. As an example, in 2006, states took 3,694 enforcement actions against mortgage lenders and brokers.

Coordinated State and Federal Initiatives

CSBS-AARMR Guidance on Nontraditional Mortgage Product Risks

CSBS and AARMR also partnered together to develop guidance on nontraditional mortgage product risks. In October 2006, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National

Credit Union Administration (NCUA) issued final Interagency Guidance on Nontraditional Mortgage Product Risks. The interagency guidance applies to all banks and their subsidiaries, bank holding companies and their nonbank subsidiaries, savings associations and their subsidiaries, savings and loan holding companies and their subsidiaries, and credit unions.

Recognizing that the interagency guidance is important and useful, but does not apply to those mortgage providers not affiliated with a bank holding company or an insured financial institution, CSBS and AARMR developed parallel guidance. Both CSBS and AARMR strongly support the purpose of the interagency guidance and are committed to promoting uniform application of its underwriting standards and consumer protection provisions for all borrowers. In order to maintain regulatory consistency, the guidance developed by CSBS and AARMR substantially mirrors the interagency guidance, except for the deletion of sections not applicable to non-depository institutions.

Released on November 14, 2006, the CSBS-AARMR guidance has been offered to state regulators to apply to their licensed residential mortgage brokers and lenders. The CSBS-AARMR guidance is intended to hold state-licensed mortgage providers to effectively the same standards as developed by the federal regulators.

As of today, 38 states plus the District of Columbia have adopted the guidelines developed by CSBS and AARMR. Ultimately, CSBS expects all 50 states to adopt the guidance in some form.[3] Once fully adopted nationwide, all mortgage lenders and brokers will be held to the same underwriting and consumer protection standards for nontraditional mortgage products.

[3] To track state adoption of the CSBS-AARMR guidance, go to http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/FederalAgencyGuidanceDatabase/State_Implementation.htm.

Proposed Interagency Statement on Subprime Mortgage Lending

CSBS and AARMR have also offered our strong endorsement of the federal interagency Statement on Subprime Mortgage Lending. In conjunction with the 2006 Interagency Guidance on Nontraditional Mortgage Product Risks and the parallel CSBS-AARMR guidance, the proposed statement offers sound underwriting and consumer protection principles that institutions and all residential mortgage providers should consider when making residential mortgage loans. Within days after the issuance of the federal guidance, CSBS and AARMR issued a parallel statement for state supervisors to use with state-supervised entities. All 50 states are expected to adopt the statement on subprime lending, providing state agencies with an additional supervisory tool to protect consumers, ensure sound underwriting standards, and hopefully decrease the number of foreclosures nationwide.

Consumer and Industry Alerts

Our supervisory efforts are not limited to our licensees, as the state agencies reach out to consumers and borrowers as well. Aware of the potential impact of upcoming resets, CSBS and AARMR issued a joint Consumer Alert and an Industry Letter on mortgage payment increases in June.

The Consumer Alert urged homeowners with adjustable rate mortgages to plan ahead for the schedule recasts or resets of interest rates in the year ahead. Specifically, the Consumer Alert urges borrowers to:

- Seek information on the characteristics of their mortgage;
- Budget accordingly;
- Contact their servicer for assistance if needed; and

- Inquire about possible solutions if payments are past due.

CSBS and AARMR also issued an Industry Letter encouraging mortgage servicers and providers to reach out to consumers to provide information on their loans to work with consumers to avoid foreclosure.

While we cannot and do not want to prevent the financial repercussions of unwarranted risk-taking, foreclosures are devastating for the individual borrower, and have a terrible impact upon the community. Ultimately, it is in everyone's best interest -- consumer, lender, servicer, investor, and regulator -- to prevent foreclosure.

Calls for Improved Disclosure

State regulators hear again and again from our citizens that they do not understand the information lenders give them, or do not receive this information in the format they need or at the time that they need it. Recognizing this need, we proposed at the Federal Reserve's HOEPA hearing a simplified one-page disclosure intended to provide the most critical information a borrower needs in order to make an informed decision.

More Coordinated State/Federal Supervision

The Federal Reserve has been and will continue to be a crucial partner in our efforts, as will the other federal regulatory agencies. State and federal regulators have come together on an unprecedented scale, and are currently actively engaged in several initiatives designed to protect consumers by preventing foreclosures, providing uniform and consistent industry supervision, and restoring the public trust by improving transparency in the market.

CSBS joined the federal banking agencies on September 4 in a statement that encouraged federally regulated institutions and state-supervised mortgage servicers to pursue strategies to mitigate losses while preserving home ownership to the extent possible and appropriate.

Specifically, we are encouraging servicers to use the authority that they have under their governing securitization documents to take the appropriate steps when an increased risk of default is identified, including:

- Proactively identifying borrowers at heightened risk of delinquency or default;
- Contacting at-risk borrowers to assess their ability to repay;
- Assessing whether there is a reasonable basis to conclude that default is "reasonably foreseeable;" and
- Exploring, where appropriate, a loss mitigation strategy that avoids foreclosure or other actions that result in a loss of homeownership.

We recently also announced with our federal counterparts a pilot program where the states will join with the Federal Reserve, Office of Thrift Supervision and the Federal Trade Commission to conduct targeted consumer-protection compliance reviews of selected non-depository lenders with significant subprime mortgage operations.

This pilot program will begin in the fourth quarter of 2007, and will focus on non-depository subsidiaries of bank and thrift holding companies, as well as mortgage brokers doing business with, or working for, these entities.

A similar pilot program is underway between the OCC and certain large states. Here the focus will be on examining national banks simultaneously with the mortgage brokers originating loans for the national banks.

State Predatory Lending Laws

Currently, 36 states plus the District of Columbia have enacted predatory lending laws.[4] Attached as Exhibit A is a list of chart of state predatory mortgage lending statutory provisions. First adopted by North Carolina in 1999, these state laws generally supplement the federal protections of the Home Ownership and Equity Protection Act of 1994 (HOEPA). The innovative actions taken by state legislatures have prompted significant

[4] Source: National Conference of State Legislatures.

changes in industry practices, as the largest multi-state lenders have adjusted their practices to comply with the strongest state laws. All too often, however, we are frustrated in our efforts to protect consumers by the preemption of state consumer protection laws by federal statutes.

Prospects for Federal Legislation and the Impact on State Authority

As the problems of mortgage lending, and particularly subprime lending, have grabbed the attention of the national press they have also garnered the focus of the Congress. A number of bills to create new federal regulation for the mortgage lending industry have been introduced by key Members of Congress. Congressional House and Senate Democratic leadership announced last week their plans to move legislation in the coming months. Legislative proposals could range from a federalization of applicable law and all regulation of the mortgage industry to federal standards for lending and licensing that can be implemented and enforced by the states. In Washington, the failings of the current system of regulation have often been portrayed as the failing of state laws and supervision. State authority is clearly threatened in Federal legislative efforts. If it is to be preserved, improvements in state supervision of mortgage brokers and nonbank lenders and state/federal cooperative regulatory efforts will have to been perceived as succeeding.

Conclusion

After the savings and loan crisis in the 1980s, states have played an ever increasing role in regulating the mortgage industry, particularly in the area of the origination or the taking of a mortgage loan application from a consumer. The evolution of the states' role in this process has created a vast infrastructure to protect consumers and regulate mortgage companies and professionals. This infrastructure includes the gathering, detection and processing of complaints that are (1) provided by consumers to regulatory agencies, attorney general's office and consumer hotlines; (2) obtained from tips from other mortgage companies or service providers; and (3) detected in agency investigations and examinations. The states' infrastructure also includes the resolution of consumer complaints through (1) agency investigations, examinations, administrative hearings, and enforcement actions and sanctions; (2) agency civil actions; and (3) state criminal actions.

The Nationwide Mortgage Licensing System will assist regulators and law enforcement agencies from all participating states by providing an electronic system with consistent data on companies and professionals in the mortgage industry. Regulators will be able to approve license applications, amendments and renewals more quickly through a more efficient process and with more comprehensive information. Regulators and law enforcement agencies will also have current data to enforce state regulations and laws and prevent disreputable industry professionals from successfully hiding by migrating from company to company, state to state or industry to industry. The weeding out of bad actors benefits the consumer and industry.

A nationwide state licensing system is not a new concept. It was successfully done by the state regulators in the securities and investment advisory industries in the early 1980s and late 1990s, respectively. As the mortgage industry and its regulation has evolved and matured over the past 20 years, it is now time for state regulators to come together to develop such a system for the mortgage industry.

As legislatures and regulators look at the best way to protect consumers and increase home ownership, one recognizes that ultimately there is a trade-off between increasing the availability of mortgage credit and the level of foreclosures. CSBS is concerned by this trade-off. State mortgage supervisors are finely tuned to the needs of the communities we serve and are not only concerned with national trends, but with the overall economic health of our local communities. Even a relatively small number of foreclosures can be devastating to a small town.

Regulators and legislators must find a balance between encouraging market innovation, product choice and credit availability with consumer protection. The states will continue to improve supervision of the mortgage industry by strengthening state statutes, signing on to the CSBS-AARMR mortgage licensing system, or adopting parallel guidance for our regulated entities. Only by continuing coordination on a nationwide level can we create an effective supervisory framework that both protects consumers and supports financial services providers.

Subprime lending can prove very beneficial to consumers as they try to access the capital necessary to purchase a home. Product choices and payment options allow consumers the flexibility to tailor their mortgage to their specific needs. These innovations in the mortgage market are positive developments. But with any market expansion and increase in complexity, there will also be an increase in the opportunity for predatory lending and fraudulent lending practices. Each state financial regulator is charged to protect their consumers while allowing the financial service providers the opportunity to compete with their fellow providers and flourish in the marketplace in a safe and sound manner.

The interagency guidance on nontraditional mortgage products, the proposed statement on subprime mortgage lending, the parallel guidance, and the nationwide licensing system developed by CSBS and AARMR address safety and soundness concerns within the mortgage industry and provide effective consumer protections. These tools will improve the quality of mortgage loans, which I believe will therefore decrease the number of residential foreclosures made under these guidelines.

It is not the goal of CSBS to limit credit access to subprime borrowers or those consumers that are traditionally underbanked. State regulators must continue to vigilantly supervise the residential mortgage industry to improve the quality of credit available to consumers, improve standards for loan providers, ensure consumer protection provisions, and punish those who engage in predatory or abusive practices. The economy is not benefited by putting consumers in homes they cannot afford. Instead, we are working towards a marketplace with cooperative and seamless supervision that benefits both consumers and providers.

Thank you again for your invitation to testify today and for the Study Committee's interest in improving mortgage regulatory system.